FOCUSED ON OUR POTENTIAL

Annual Report 2012

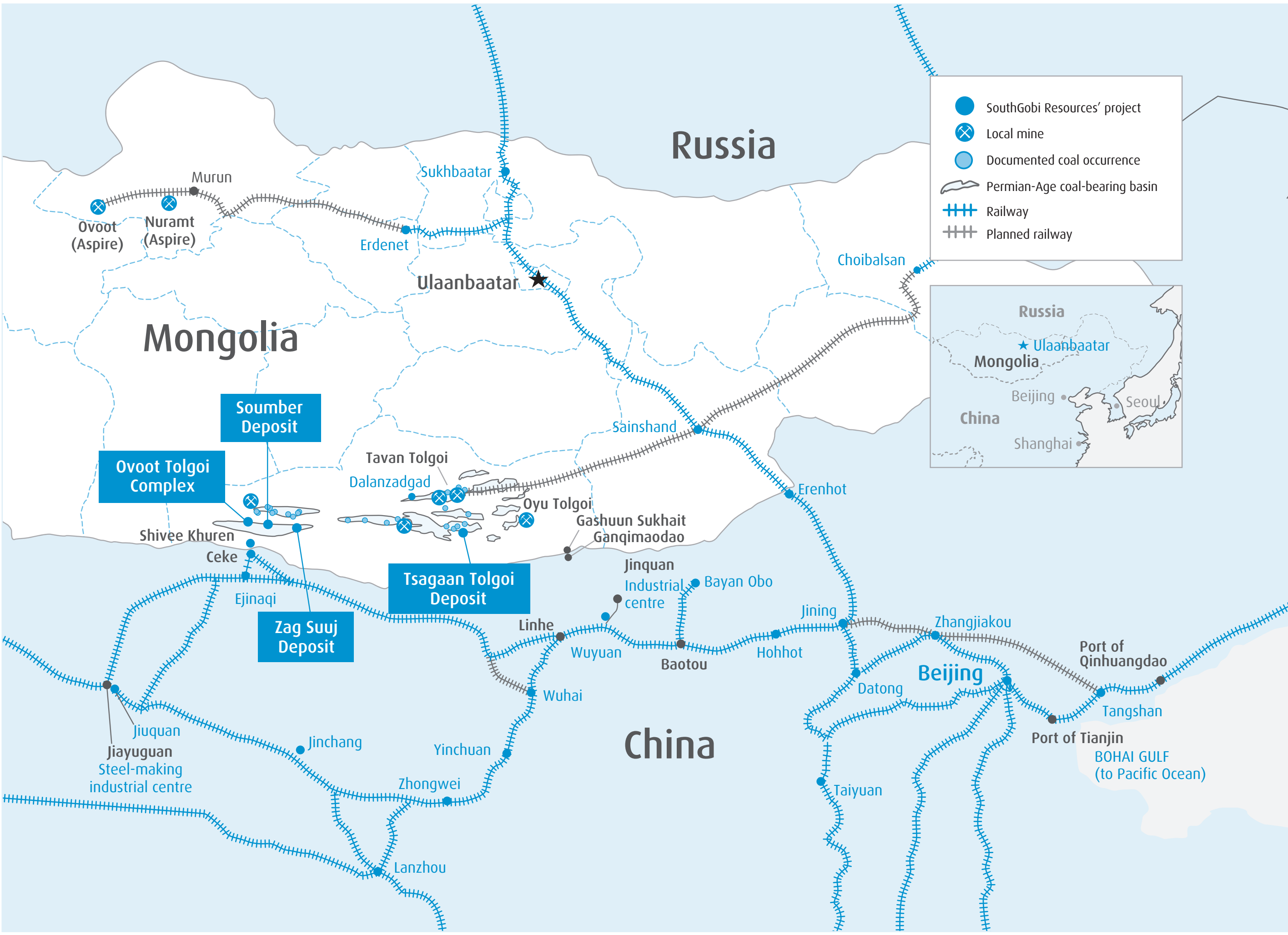
TSX: SGQ HKEX :1878

SouthGobi Resources Ltd.
Annual Report 2012

Contents

SouthGobi Resources Ltd. (the "Company" or "SouthGobi") is focused on the exploration, development and production of its coking coal deposits in Mongolia's South Gobi Region.

The Company has a 100% shareholding in SouthGobi Sands LLC, the Mongolian registered company that holds SouthGobi's mining and exploration licenses in Mongolia and operates the flagship Ovoot Tolgoi coal mine. Ovoot Tolgoi produces and sells coal to customers in China.



Significant events

The Company's significant events for the year ended December 31, 2012 and subsequent weeks are as follows:

- 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. Operations had been fully curtailed since the end of June 2012;
- Annual coal 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;
- Commissioned dry coal-handling facility at the Ovoot Tolgoi Mine;
- Received official notification of Aluminum Corporation of China Limited's ("CHALCO") 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, SouthGobi was notified that CHALCO's proportional takeover bid had been terminated;
- Mineral Resources Authority of Mongolia ("MRAM") held a press conference announcing a request to suspend exploration and mining activity on certain licenses owned by SouthGobi Sands LLC, a wholly-owned subsidiary of SouthGobi Resources Ltd. Subsequently, SouthGobi received a letter from MRAM confirming that as of September 4, 2012 all exploration and mining licenses held by SouthGobi were in good standing;
- The opening of expanded border crossing infrastructure at the Shivee Khuren-Ceke crossing at the Mongolia-China border ("Shivee Khuren Border Crossing");
- Ribbon cutting ceremony to commemorate the start of construction on the new paved coal highway from the Ovoot Tolgoi Complex to the Shivee Khuren Border Crossing;
- 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;
- SouthGobi announced changes to its Board of Directors and senior management team;
- Provided an update on the ongoing governmental, regulatory and internal investigations;
- Received a pre-mining agreement pertaining to the Soumber Deposit;
- On March 25, 2013, SouthGobi announced updated NI 43-101 compliant resource estimates for the Soumber and Zag Suuj Deposits, which increased SouthGobi's total measured and indicated resources to 533 million tonnes (8% increase) and inferred resources to 302 million tonnes (24% increase).

Our reserves and resources

Below is a summary of the Company's reserves and resources (expressed in millions of tonnes):

Reserves

Area	Proven	Probable	Total
Ovoot Tolgoi Mine	119	57	176

Resources

Area	Measured	Indicated	Total measured and indicated	Inferred
Ovoot Tolgoi Mine	133	60	193	24
Ovoot Tolgoi Underground	66	43	109	62
Soumber	63	110	173	123
Tsagaan Tolgoi	23	13	36	9
Zag Suuj	–	22	22	84
Total Resources	**285**	**248**	**533**	**302**

Message from the Chairman

Kay Priestly Chairman of the Board, Non-Executive Director

With the appointment of five new directors, I believe we have an extremely experienced board with complementary skills including extensive mining and Mongolian operations experience and good corporate governance practice.

SouthGobi went through significant change and addressed a number of challenges throughout 2012. The impact of the proposed transaction with the Aluminum Corporation of China Limited ("CHALCO"), customer reactions to license uncertainty, curtailed operations, investigations of SouthGobi employees by Mongolian authorities and the deterioration of coking coal market conditions took its toll on the Company.

There has also been a significant corporate transformation at SouthGobi in the past year. In early September 2012, the Company announced significant changes to the Board of Directors including my appointment and being named Chairman.

With the appointment of five new Directors, I believe we have an extremely experienced board with complementary skills including extensive mining and Mongolian operations experience and good corporate governance practice. The Board of Directors will continue to strive to ensure international best practice in all aspects of governance, maintain our good health and safety record and best serve the interest of the Company.

I would like to take this opportunity to acknowledge the long-standing service that past Chairman Peter Meredith provided to SouthGobi. Peter's guidance and leadership was instrumental in discovering, developing and successfully operating the Ovoot Tolgoi Mine.

Furthermore, beginning in September 2012, we announced major changes to SouthGobi's senior management team including the appointment of Ross Tromans, an industry veteran with over 30 years' experience, as President and Chief Executive Officer.

Following the board and management changes, we undertook a comprehensive strategic review of the business, which resulted in a specifically designed rebuilding program to return SouthGobi to sustainable and profitable long-term operations. Implementation of the program has commenced and operations at the Ovoot Tolgoi Mine restarted on March 22, 2013.

Throughout 2013, we expect to make additions to SouthGobi's senior management team. The appointments will provide additional management strength and ultimately maximize the Company's resource value. Navigating through uncertain times requires a prudent approach to financial management and preserving SouthGobi's cash position. Despite the recent challenges experienced by SouthGobi, I believe the fundamentals of the Company remain very solid.

SouthGobi's Ovoot Tolgoi Mine is strategically positioned next to China, one of the world's largest coal consumers. The Company's access to critical infrastructure, premium-quality coal, advantageous cost structure and strong resource base underpin SouthGobi's long-term competitive strengths.

Throughout 2013, our emphasis will be on implementing the first steps of our value accretive rebuilding program and laying the foundation for sustainable long-term operations that capture SouthGobi's competitive advantages.

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

Kay Priestly
Chairman of the Board, Non-Executive Director

Message from the President and CEO

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

Throughout 2013 we will maintain our focus on operational excellence with an eye toward enhancing production safety, environmental protection and community relations.

2012 was a tumultuous year for SouthGobi. The Company faced a number of significant challenges including full production curtailment at the Ovoot Tolgoi Mine, the announced and subsequently terminated proportional takeover bid by the Aluminum Corporation of China Limited ("CHALCO") and ongoing investigations by the Mongolian authorities. There were also extensive changes to the Company's Board of Directors and senior management during the year, including my appointment as President and Chief Executive Officer.

The full production curtailment at the Ovoot Tolgoi Mine was in place from the end of June 2012 through the end of 2012 due to softening of inland China coking coal markets and difficult operating conditions in Mongolia. This resulted in management cutting costs to preserve SouthGobi's long-term financial position and included the suspension of uncommitted capital expenditures and the reduction of the Company's workforce by nearly one third. Exploration expenditures were reduced to levels required to protect our existing licenses. The Company's net loss of $103.0 million in 2012 reflects these difficult conditions.

The Company has been subject to investigations by Mongolian authorities regarding allegations against SouthGobi and some of its employees involving possible breaches of Mongolian laws including anti-corruption and taxation laws. Some of these investigations are ongoing in 2013. The Mineral Resources Authority of Mongolia ("MRAM") held a press conference in April 2012 announcing a request to suspend the Company's exploration and mining licenses. However, the Company never received formal notification and in September 2012 MRAM formally confirmed that all exploration and mining licenses held by the Company were in good standing. There has been no formal change to this position since that time.

Safety is a priority for our Company in the way we operate and even though production was fully curtailed for the second half of the year I am pleased to report that there were no lost time injuries in 2012. The focus on safety will continue in 2013 as we strive for zero harm within our Company.

I would like to take this opportunity to thank all of SouthGobi's employees who have persevered during 2012 as we dealt with these challenges. They have been very supportive of me in my new role and share my outlook for the long-term position of the Company. As I look ahead to 2013, the coal market still has a number of uncertainties that need to be overcome, but the outlook for the year is more positive. The Mongolian coal industry is quite dependent on the Chinese market and the industry has been assessing potential changes to the Chinese economy with the Chinese leadership transition since the conclusion of the Chinese Lunar New Year in early February. The prevailing view of most industry commentators is that Chinese demand for coking coal will continue to improve to levels that support more favourable market conditions for producers. However, the level of supply from Chinese and other international coal producers is also expected to remain firm and this will likely limit price increases, reduce pricing volatility and minimize major market fluctuations throughout 2013.

Operations resumed at the Ovoot Tolgoi Mine on March 22, 2013 at levels that reflect both market conditions and our production capabilities. Our forecast production for 2013 is 3.2 million tonnes of semi-soft product. Our capability to begin supplying a washed product in the second half of the year is another important step in improving both our market position and access to end customers.

One of our main priorities in 2013 is to complete the construction of the paved highway from Ovoot Tolgoi to the Shivee Khuren Border Crossing. The paved highway will have an intended carrying capacity upon completion in excess of 20 million tonnes of coal per year and will greatly increase the ability of the Company to expedite the movement of its coal to China.

A second priority for 2013 includes substantially advancing the feasibility, planning and physical preparation for a mine at the Soumber Deposit by 2014. The Soumber Deposit is located about 20 kilometers ("km") east of the Ovoot Tolgoi Mine, which will allow any future mining operation at this deposit to share existing infrastructure with the Ovoot Tolgoi Mine.

A third priority for 2013 involves implementation of a strategy to effectively utilize the wet washing facility contracted with Ejin Jinda, a subsidiary of China Mongolia Coal Co. Ltd, to toll-wash coal from the Ovoot Tolgoi Mine and further develop our product mix and expand our customer base.

Lastly, throughout 2013 we will maintain our focus on operational excellence with an eye toward continuing to enhance safety, environmental protection and community relations. We will also continue to reinforce our core values of ethical behavior in dealing with our stakeholders at all levels of the Company.

In the longer term, SouthGobi remains well positioned, with a number of key strengths and competitive advantages as a base to grow our Company as a larger coal producer in Mongolia.

SouthGobi is strategically positioned as the closest major coking coal producer in the world to China. The Ovoot Tolgoi Mine is about 40km from China which compares favourably to some other Mongolian producers and significantly closer than Australian and North American producers. We also have an infrastructure advantage, being approximately 50km from existing railway infrastructure in China.

Most of SouthGobi's premium-quality coal resources have coking properties, including a mixture of semi-soft coking coals and hard coking coals. As we complete our investment in processing infrastructure, we anticipate being able to capture more value from our product mix.

Our long term cost structure provides a strong base for sustainable growth as further access to end-user market is obtained and we compete with other Chinese, Mongolian and international producers to capture greater margin from our products.

I am optimistic for 2013 and believe that we will have the people and resources to move towards our vision as a respected and profitable Mongolian coal company. We look forward to enhancing relationships with our current and prospective customers and our numerous external stakeholders, and putting our vision for the Company into action throughout the year.

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

STRATEGIC LOCATION CLOSE TO CHINA

Approximately 40km to China
and 50km to transportation
infrastructure

1

Closest coal to China

2

Rail access at
Chinese border

3

Benefitting from improved
logistics in China and
market dynamics

Board of Directors and Senior Management

Kay Priestly
Chairman of the Board, Non-Executive Director

Ms. Priestly, 57, joined the Company as the Chairman of the Board and a Non-Executive Director on September 3, 2012. She is a Director and the Chief Executive Officer of Turquoise Hill Resources Ltd. Ms. Priestly has more than 30 years of experience in the financial, mining and energy sectors. She previously was a senior executive at Rio Tinto, most recently serving as Chief Financial Officer of the company's global Copper product group. Ms. Priestly joined Rio Tinto in 2006 as Chief Financial Officer at Rio Tinto's Kennecott Utah Copper operations. Prior to Rio Tinto, she spent more than 25 years with global professional services firm Arthur Andersen, where she provided tax and consulting services to global companies in the energy and mining sectors and was a member of Andersen's global executive team.

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

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

Mr. Tromans, 56, joined the Company as President and Chief Executive Officer on September 17, 2012 and in October 2012 also assumed the duties formerly handled by the Chief Operating Officer. Until the Company identifies a suitable replacement for the role of Chief Financial Officer, Mr. Tromans is acting as the Company's Principal Financial Officer. Mr. Tromans was appointed to the Board of Directors on November 7, 2012.

Mr. Tromans has over 30 years of sales and marketing experience in the coal and energy sectors covering the Asian and North American markets. Most recently, he was General Manager Marketing at Rio Tinto Coal Australia where he was responsible for the development and implementation of the overall marketing strategy for thermal, coking and semi-soft coal. Previously, Mr. Tromans held senior roles at Rio Tinto including General Manager Marketing and Sales at Rio Tinto Alcan, Director New Markets and Service at Kennecott Energy and General Manager Marketing at Kaltim Prima Coal.

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

Mr. Tromans is based in Ulaanbaatar, Mongolia.

Sean Hinton
Deputy Chairman and Non-Executive Director

Mr. Hinton, 46, joined the Company as the Deputy Chairman and Non-Executive Director on September 3, 2012. Mr. Hinton is founder and principal of Terbish Partners, an advisory firm mainly focused on energy and mining projects. Mr. Hinton has more than 24 years' experience in Mongolia, from 1997 to 2000 he served as Mongolia's Honorary Consul-General in Australia, and speaks fluent Mongolian.

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

Pierre Lebel
Independent Non-Executive Director and Lead Director

Mr. Lebel, 63, joined the Company as an Independent Non-Executive Director on August 13, 2003. Mr. Lebel is the Company's Lead Director and served as its Chairman from 2003 until June 2007. He has a distinguished career in mining spanning over 30 years, with a primary focus on mine financing, construction and development. Mr. Lebel currently serves as Chairman and a Director of Imperial Metals Corporation, a TSX-listed mine developer and operator. In 1998, Mr. Lebel was awarded the E.A. Scholz Medal by the British Columbia and Yukon Chamber of Mines for excellence in mine development in British Columbia.

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

André Deepwell
Independent Non-Executive Director

Mr. Deepwell, 58, joined the Company as an Independent Non-Executive Director on August 13, 2003. He has been the Chief Financial Officer and Corporate Secretary of a number of natural resource companies over the last 15 years and is currently Chief Financial Officer and Corporate Secretary of Imperial Metals Corporation, a TSX-listed mine developer and operator. Mr. Deepwell has been involved in all aspects of debt and equity financings and financial reporting for mining enterprises ranging from grassroots exploration to mine development and production.

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

W. Gordon Lancaster

Independent
Non-Executive Director

Mr. Lancaster, 69, joined the Company as an Independent Non-Executive Director on May 11, 2010. He is currently an independent business consultant. Mr. Lancaster was Chief Financial Officer of Ivanhoe Energy Inc., an international heavy-oil development and production company whose core operations are in Canada, Ecuador and China. Prior to joining Ivanhoe Energy Inc. in 2004, he was Chief Financial Officer of Power Measurement Inc., a Victoria-based high-tech company that is a world leader in the design, development, manufacture and marketing of enterprise energy management systems.

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

Lindsay Dove

Non-Executive Director

Mr. Dove, 64, joined the Company as a Non-Executive Director on September 3, 2012. Mr. Dove is currently an independent mining consultant and has over 30 years of experience in the international oil, coal and shipping industries with BP p.l.c. and Rio Tinto, where he held a variety of senior management positions. Since retiring from Rio Tinto in 2006, Mr. Dove has been an independent consultant advising on acquisitions and corporate transactions, primarily in the international coal mining industry.

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

Brett Salt
Non-Executive Director

Mr. Salt, 37, joined the Company as a Non-Executive Director on September 3, 2012. He was appointed Senior Vice President, Strategy and Development at Turquoise Hill Resources Ltd. on May 1, 2012. Previously, Mr. Salt was with Rio Tinto for 15 years in a variety of senior product group and corporate level commercial roles. Most recently, he was General Manager Business Development and Chief Financial Officer of the Rio Tinto Marine business.

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

Kelly Sanders
Non-Executive Director

Mr. Sanders, 55, joined the Company as a Non-Executive Director on September 3, 2012. Mr. Sanders is currently the President and CEO of Rio Tinto's Kennecott Utah Copper operations and has been working in the mining industry for 30 years, including 28 years involved with coal mining operations. Mr. Sanders previously held senior positions with Rio Tinto Energy America and Ziegler Coal, both in Wyoming's famed Powder River Basin coal mining district.

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

PREMIUM QUALITY COAL

Majority of the Company's known coal resources have coking properties

1

Ovoot Tolgoi dry coal handling facility commissioned in 2012 and will enable beneficiation of raw coals

2

Wet wash plant capacity at Ceke secured to beneficiate coals

Directors' report

The Board of Directors (the "Board") of SouthGobi Resources Ltd. is pleased to present their report along with the audited consolidated financial statements (the "Financial Statements") of SouthGobi Resources Ltd. together with its subsidiaries (collectively the "Company") for the financial year ended December 31, 2012 ("Financial Year").

Principal activities and geographical analysis of operations

The Company is an integrated coal mining, development and exploration company. In 2012, the Company's major shareholder, Turquoise Hill Resources Ltd., experienced a change of control as Rio Tinto moved to a 51% ownership position. In September 2012, the Company announced significant changes to the Board which saw three (3) board members resigning and an additional five (5) board members appointed. The Company's principal subsidiaries are set out in Note 26 of the Financial Statements and the activities of all subsidiaries of the Company at December 31, 2012 are set out in the table below:

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

The analysis of the principal activities by geographical location of the operations of the Company for the Financial Year is set out in Note 4 of the Financial Statements.

Results

The results of the Company for the Financial Year are set out in the Consolidated Statement of Comprehensive Income on page 96.

Dividends

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

Property, plant and equipment

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

Share capital

Details of the movement in the share capital of the Company during the Financial Year are set out in the Consolidated Statement of Changes in Equity on page 98.

During the Financial Year, the Company repurchased its own shares on the Toronto Stock Exchange and Hong Kong Stock Exchange. Details of the shares repurchased are set out on page 144. The share repurchase program concluded on June 14, 2012.

Reserves

Details of the reserves available for distribution to the shareholders as at December 31, 2012 are set out in the Consolidated Statement of Changes in Equity on page 98.

Directors

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

Independent non-executive directors

Mr. Pierre Lebel *(Lead Director)*
Mr. André Deepwell
Mr. W. Gordon Lancaster
Mr. R. Stuart (Tookie) Angus (1)
Mr. Robert Hanson (2)
Mr. R. Edward Flood (2)

Executive directors

Mr. K. Ross Tromans
Mr. Alexander Molyneux (3)

Non-executive directors

Ms. Kay Priestly *(Chairman)*
Mr. Sean Hinton *(Deputy Chairman)*
Mr. Lindsay Dove
Mr. Brett Salt
Mr. Kelly Sanders
Mr. Peter Meredith (2)
Mr. John Macken (4)

Notes:
(1) Mr. Angus did not stand for re-election at the Annual General Meeting held on May 17, 2012.
(2) Messrs. Flood, Hanson and Meredith resigned from the Board on September 3, 2012.
(3) Mr. Molyneux resigned from the Board on September 12, 2012.
(4) Mr. Macken resigned from the Board on April 17, 2012.

Except where such director has already resigned from the Board, the term of office for each of the directors will end at the conclusion of the forthcoming annual general meeting. Each of the directors who currently sit on the Board, offers themselves for re-election at the annual general meeting scheduled for May 8, 2013.

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

Directors' service contracts

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

Directors' interests in contracts of significance

No contracts of significance to which the Company was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at December 31, 2012 or at any time during the Financial Year.

Directors' interests in competing businesses

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

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

At December 31, 2012, or in the case of departed directors as at their resignation date, the interests of the directors and senior management in the shares and share options of the Company and its associated corporations were as follows:

Shares

Name	Name of company	Nature of interest	Shares held	Approximate % interest in the company
Ms. Kay Priestly	SouthGobi Resources Ltd.	N/A	Nil	Nil
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	Personal	47,952	0.00%
Mr. K. Ross Tromans	SouthGobi Resources Ltd.	N/A	Nil	Nil
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	Personal	31,057	0.00%
	Rio Tinto plc	N/A	Nil	Nil
Mr. Sean Hinton	SouthGobi Resources Ltd.	N/A	Nil	Nil
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	N/A	Nil	Nil
Mr. Pierre Lebel	SouthGobi Resources Ltd.	Personal	5,100	0.00%
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	N/A	Nil	Nil
Mr. André Deepwell	SouthGobi Resources Ltd.	Personal/Indirect(1)	45,000	0.02%
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	N/A	Nil	Nil
Mr. W. Gordon Lancaster	SouthGobi Resources Ltd.	N/A	Nil	Nil
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	N/A	Nil	Nil
Mr. Lindsay Dove	SouthGobi Resources Ltd.	N/A	Nil	Nil
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	Indirect(2)	11,500	0.00%
Mr. Brett Salt	SouthGobi Resources Ltd.	N/A	Nil	Nil
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	Personal	4,686	0.00%
Mr. Kelly Sanders	SouthGobi Resources Ltd.	N/A	Nil	Nil
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	Personal	52,526	0.00%
Mr. Peter Meredith	SouthGobi Resources Ltd.	N/A	Nil	Nil
	Turquoise Hill Resources Ltd.	Personal	22,902	0.00%
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	N/A	Nil	Nil
Mr. Alexander Molyneux	SouthGobi Resources Ltd.	Personal	29,532	0.02%
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	N/A	Nil	Nil
Mr. R. Stuart (Tookie) Angus	SouthGobi Resources Ltd.	N/A	Nil	Nil
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	N/A	Nil	Nil
Mr. Robert Hanson	SouthGobi Resources Ltd.	Personal/Indirect(3)	12,500	0.00%
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	N/A	Nil	Nil
Mr. John Macken	SouthGobi Resources Ltd.	N/A	Nil	Nil
	Turquoise Hill Resources Ltd.	Personal	279,216	0.03%
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	N/A	Nil	Nil
Mr. R. Edward Flood	SouthGobi Resources Ltd.	N/A	Nil	Nil
	Turquoise Hill Resources Ltd.	Personal	22,298	0.00%
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	N/A	Nil	Nil

(1) 43,000 shares of SouthGobi Resources Ltd. held by the spouse of Mr. André Deepwell.
(2) 11,500 shares of Rio Tinto plc held by the spouse of Mr. Lindsay Dove.
(3) Mr. Robert Hanson holds 7,500 shares of SouthGobi Resources Ltd. on behalf of a third party.

Share Options

Name	Name of company	Options held
Ms. Kay Priestly	SouthGobi Resources Ltd.	Nil
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	6,298
Mr. K. Ross Tromans	SouthGobi Resources Ltd.	Nil
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	7,235
	Rio Tinto plc	Nil
Mr. Sean Hinton	SouthGobi Resources Ltd.	50,000
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil
Mr. Pierre Lebel	SouthGobi Resources Ltd.	195,000
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil
Mr. André Deepwell	SouthGobi Resources Ltd.	190,000
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil
Mr. W. Gordon Lancaster	SouthGobi Resources Ltd.	220,000
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil
Mr. Lindsay Dove	SouthGobi Resources Ltd.	50,000
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil
Mr. Brett Salt	SouthGobi Resources Ltd.	Nil
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil
Mr. Kelly Sanders	SouthGobi Resources Ltd.	Nil
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	9,601
Mr. Peter Meredith	SouthGobi Resources Ltd.	440,000
	Turquoise Hill Resources Ltd.	303,208
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil
Mr. Alexander Molyneux	SouthGobi Resources Ltd.	971,500
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil
Mr. R. Stuart (Tookie) Angus	SouthGobi Resources Ltd.	115,000
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil
Mr. Robert Hanson	SouthGobi Resources Ltd.	167,500
	Turquoise Hill Resources Ltd.	86,297
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil
Mr. John Macken	SouthGobi Resources Ltd.	463,500
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil
Mr. R. Edward Flood	SouthGobi Resources Ltd.	167,500
	Turquoise Hill Resources Ltd.	124,555
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil

Other than the holdings disclosed in the preceding tables, none of the directors, senior management and their associates had any interests or short positions in any shares, underlying shares or debentures of the Company or of its associated corporations as at December 31, 2012.

Management contracts

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

Share option plan

The particulars of the Company's share option plan are set out in Note 22 of the Financial Statements.

The following table discloses movements in the Company's share options for the Financial Year:

Name	Outstanding at beginning of year	Granted during the year	Exercise price (Cdn$)	Exercised during the year	Forfeited during the year	Expired during the year	Outstanding at year end
Ms. Kay Priestly	–	–	–	–	–	–	–
Mr. K. Ross Tromans	–	–	–	–	–	–	–
Mr. Sean Hinton	–	50,000	1.92	–	–	–	50,000
Mr. Pierre Lebel	230,000	20,000	6.16	–	–	(75,000)	195,000
		20,000	1.92				
Mr. André Deepwell	200,000	20,000	6.16	–	–	(50,000)	190,000
		20,000	1.92				
Mr. W. Gordon Lancaster	185,000	17,500	6.16	–	–	–	220,000
		17,500	1.92				
Mr. Lindsay Dove	–	50,000	1.92	–	–	–	50,000
Mr. Brett Salt	–	–	–	–	–	–	–
Mr. Kelly Sanders	–	–	–	–	–	–	–
Mr. Peter Meredith	745,000	30,000	6.16	(335,000)	–	–	440,000
Mr. Alexander Molyneux	1,350,000	200,000	6.16	–	(578,500)	–	971,500
Mr. R. Stuart (Tookie) Angus	150,000	–	–	–	(150,000)	–	–
Mr. Robert Hanson	150,000	17,500	6.16	–	–	–	167,500
Mr. John Macken	446,000	17,500	6.16	–	–	(463,500)	–
Mr. R. Edward Flood	150,000	17,500	6.16	–	–	–	167,500
Total for directors	3,606,000	497,500		(335,000)	(728,500)	(588,500)	2,451,500
Total for other share option holders	7,161,964	1,568,750		(97,600)	(1,370,600)	(2,206,284)	5,056,230
Total	**10,767,964**	**2,066,250**		**(432,600)**	**(2,099,100)**	**(2,794,784)**	**7,507,730**

Details of the accounting policy for the Company's share option plan are set out in Note 3.11 of the Financial Statements.

Arrangement to purchase shares and debentures

In addition to the share option holdings disclosed above, certain members of the Company's Board and former senior management participated in the Company's share purchase plan, which allows the Company's eligible employees to contribute up to 7% of their basic annual salary to purchase shares in the Company. The Company contributes 50% of the employee's contribution and at the end of each calendar quarter shares are purchased on behalf of the employee.

Substantial shareholders

The register of interests in shares and short positions of the Company showed that as at December 31, 2012, the Company has been notified of the following interests in shares representing 5% or more of the Company's issued share capital:

Name	Nature of interest	Shares held	Approximate % of issued shares
Turquoise Hill Resources Ltd. (formerly Ivanhoe Mines Ltd.)	Beneficial	104,807,155	57.60%
China Investment Corporation	Beneficial	25,539,834	14.04%
Deutsche Bank AG	Beneficial	10,896,889	5.99%
	Short position	163,540	0.08%
UBS AG	Beneficial	9,103,336	5.00%
	Short position	876,779	0.48%

Other than as disclosed above, the Company has not been notified of any relevant interests or short positions in the issued share capital of the Company as at December 31, 2012.

Emolument policy

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

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

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

Pre-emptive rights

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

Sufficiency of public float

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

Major customers and suppliers

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

Purchases

The largest supplier accounted for 41% of the Company's purchases.

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

Sales

The largest customer accounted for 40% of the Company's sales.

The five largest customers accounted for 98% of the Company's sales.

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

Charitable donations

During the Financial Year the Company made charitable donations amounting to US$73,306.

Events after reporting period

Details of events occurring after December 31, 2012 are set out in Note 31 of the Financial Statements.

Independent auditor

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

On behalf of the Board

Kay Priestly
Chairman of the Board, Non-Executive Director
March 25, 2013

COMPETITIVE LONG-TERM COST STRUCTURE

Low cost coking coal producer

Competitive long-term cost
structure that will facilitate
sustainable growth

Corporate governance report

Corporate governance

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

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

- approved and adopted a mandate for the Board, which sets out its stewardship responsibilities;
- appointed Mr. Pierre Lebel, an independent non-executive director, as "Lead Director", with the specific responsibility of, among other things, maintaining the independence of the Board and ensuring the Board carries out its responsibilities mandated by applicable statutory and regulatory requirements and stock exchange listing standards;
- appointed an Audit Committee (composed of independent directors), a Nominating and Corporate Governance Committee (composed of independent directors and non-executive directors) and a Compensation and Benefits Committee (composed of independent directors and non-executive directors);
- appointed a Health, Environment, Safety and Social Responsibility Committee;
- approved charters for all of the Company's Board committees;
- established a management Disclosure Committee for the Company, with the mandate to oversee the Company's disclosure practices;
- formalized the Company's Corporate Disclosure, Confidentiality and Securities Trading Policy, and Disclosure Controls and Procedures;
- adopted a formal Code of Business Conduct and Ethics and a Statement of Values and Responsibilities for the Company that governs the behavior of directors, officers and employees and which is also distributed to consultants;
- adopted formalized written position descriptions for the Chairman, Lead Director, CEO and CFO, as well as the Chairs of the Audit, Compensation and Benefits and Nominating and Corporate Governance Committees clearly defining their respective roles and responsibilities;
- adopted a whistleblower policy administered by an independent third party;
- Directors and all employees of the Company have completed or are in the process of completing a *Foreign Corrupt Practices Act* training program;
- formalized a process for assessing the effectiveness of the Board as a whole, the committees of the Board and the contribution of individual directors, on a regular basis;
- adopted an executive compensation model for the Company; and
- in the process of implementing a more robust compliance program for all Directors and employees.

Compliance with corporate governance

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

In December 2012 the Company approved in principle the adoption of a compliance program based on a Rio Tinto Group model. The Nominating and Corporate Governance Committee will oversee the implementation of the standards to ensure they are fine tuned to conform with the Company's needs.

Board composition

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

Based on information regarding personal and business circumstances provided in a comprehensive questionnaire completed annually by each of the Company's directors and reasonable enquiry of the Board to determine whether or not the members of the Board are independent, the Company's Board is satisfied that three (3) of its nine (9) current members representing approximately 33% of all Board members are independent, as follows:

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

Although the majority of the board members are not independent, eight (8) of the nine (9) directors are non-executive directors. In the event the board must consider a potential or actual conflict, such matter is referred to the independent directors to ensure processes are in place to receive independent scrutiny. To facilitate the exercise of independent judgment, the independent and non-executive members of the Board meet regularly. In 2012, the independent members met four (4) times and the non-executive directors met four (4) times.

Independent non-executive directors	Non-independent directors
Mr. Pierre Lebel *(Lead Director)*	Mr. K. Ross Tromans *(President and Chief Executive Officer)* (1)
Mr. André Deepwell	Ms. Kay Priestly *(Chairman)* (2)
Mr. W. Gordon Lancaster	Mr. Brett Salt (2)
Mr. R. Stuart (Tookie) Angus (6)	Mr. Sean Hinton *(Deputy Chairman)* (3)
Mr. R. Edward Flood (7)	Mr. Lindsay Dove (4)
Mr. Robert Hanson (7)	Mr. Kelly Sanders (5)
	Mr. John Macken (8) (9)
	Mr. Peter Meredith (7) (9)
	Mr. Alexander Molyneux (10)

Notes:

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

(2) Ms. Priestly and Mr. Salt, executive officers of Turquoise Hill, are considered to be non-independent directors as a result of the material relationship between the Company and Turquoise Hill.

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

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

(5) Mr. Sanders is a senior officer of Kennecott Utah Copper, a subsidiary of Rio Tinto plc.

(6) Mr. Angus did not stand for re-election at the Annual General Meeting held on May 17, 2012.

(7) Messrs. Flood, Hanson and Meredith resigned from the Board on September 3, 2012.

(8) Mr. Macken resigned from the Board on April 17, 2012.

(9) Messrs. Macken and Meredith were considered to be non-independent directors as a result of the material relationship between the Company and Turquoise Hill, and in the case of Mr. Meredith, as a former member of management of the Company.

(10) Mr. Molyneux was a non-independent director as a result of his capacity as a former senior officer of the Company.

As at March 25, 2013, Turquoise Hill held approximately 58% of the Company's issued and outstanding common shares. The Board has determined that Messrs. Lebel, Deepwell and Lancaster are independent directors.

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

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

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

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

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

Mandate of the board

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

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

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

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

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

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

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

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

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

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

Committees of the board

Audit committee

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

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

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

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

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

The Audit Committee held five (5) meetings during the Financial Year. In performing its duties in accordance with the Audit Committee Charter, the Audit Committee has:

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

Nominating and corporate governance committee

The Board has established a Nominating and Corporate Governance Committee, which operates under a charter approved by the Board. The primary objective of the Nominating and Corporate Governance Committee is to assist the Board in fulfilling its oversight responsibilities by (a) identifying individuals qualified to become Board and committee of the Board members and recommending that the Board select director nominees for appointment or election to the Board; and (b) developing and recommending to the Board corporate governance guidelines for the Company and making recommendations to the Board with respect to corporate governance practices. The Nominating and Corporate Governance Committee monitors the disclosure of conflicts of interest to the Board and ensures that no director will vote or participate in a discussion on a matter in respect of which such director has a material interest. Committee Chairs perform the same function with respect to meetings of each Board committee. The members of the Nominating and Corporate Governance Committee are Messrs. Lebel, Deepwell, Lancaster, Hinton and Ms. Priestly. Mr. Lebel is the chairman of the Nominating and Corporate Governance Committee. Mr. Angus did not stand for re-election at the Annual General Meeting held on May 17, 2012 and resigned from the Nominating and Corporate Governance Committee at that time. Messrs. Flood and Hanson (chair) resigned from the Nominating and Corporate Governance Committee on September 3, 2012.

During the course of 2012, the Nominating and Corporate Governance Committee met nine (9) times. In performing its duties in accordance with the Nominating and Corporate Governance Committee Charter, the Nominating and Corporate Governance Committee has:

- reviewed the Nominating and Corporate Governance Committee charter to ensure the Company has the appropriate procedures and processes in place to facilitate the nomination of Directors;
- reviewed the structure, size and composition (including the skills, knowledge and experience) of the Board;
- made recommendations to the Board on the selection of individuals nominated for directorship in view of their qualifications and related expertise;
- made recommendations to the Board on the selection of individuals nominated for senior management roles;
- evaluated the Company's executive management succession plans;
- ensured that the Board has the necessary structures and procedures so that it can function with an appropriate degree of independence from management;
- provided a forum without management present to receive expressions of concern, including any concern regarding matters involving the independence of the Board from management;
- re-established and conducted induction programs for new Directors; and
- reviewed the practices and procedures of the Board in light of ongoing developments in regulatory requirements and industry best practices in matters of corporate governance and recommended to the Board any changes considered necessary or desirable.

Compensation and benefits committee

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

The members of the Compensation and Benefits Committee are Messrs. Lancaster, Deepwell, Dove and Lebel. Mr. Lancaster is the chairman of the Compensation and Benefits Committee. Mr. Angus did not stand for re-election at the Annual General Meeting held on May 17, 2012 and resigned from the Compensation and Benefits Committee at that time.

During the course of 2012, the Compensation and Benefits Committee met five (5) times. In performing its duties in accordance with the Compensation and Benefits Committee Charter, the Compensation and Benefits Committee has:

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

Health, Environment, Safety and Social Responsibility committee

The Board has established a Health, Environment, Safety and Social Responsibility ("HESS") Committee. The primary objective of the HESS Committee is to review and oversee the Company's established HESS policies and procedures at the Company's project sites. The HESS Committee also reviews any incidents that occur and provides guidance on how to prevent any recurrences. The members of the HESS Committee are Messrs. Sanders, Salt, Tromans and Dove. Mr. Sanders is the chairman of the HESS Committee. Mr. Macken resigned from the HESS Committee on April 17, 2012. Messrs. Flood and Hanson (chair) resigned from the HESS Committee on September 3, 2012. Mr. Molyneux resigned from the HESS Committee on September 12, 2012.

Mergers and acquisitions committee

The Board has established a Mergers and Acquisitions ("M&A") Committee. The primary objective of the M&A Committee is to review, assess and provide guidance on all potential acquisitions, divestitures and strategic investment transactions to which the Company may become a party. The members of the M&A Committee are Messrs. Dove, Lebel, Salt and Tromans. Mr. Dove is the chairman of the M&A Committee. Mr. Angus did not stand for re-election at the Annual General Meeting held on May 17, 2012 and resigned from the M&A Committee at that time. Mr. Flood resigned from the M&A Committee on September 3, 2012. Mr. Lancaster joined the M&A Committee on March 14, 2012 and resigned on November 7, 2012.

Ad Hoc/Special committees

In appropriate circumstances, the Board may establish a special committee to review a matter in which several directors or management may have a conflict of interest. In 2012 a Special Committee was formed to oversee the Company's interests in the proposed transaction between Turquoise Hill and Aluminum Corporation of China Limited ("CHALCO"). The Special Committee was comprised of Messrs. Lebel, Deepwell and Lancaster. Upon termination of the proposed transaction in September 2012, the Special Committee was concluded.

Through its Audit Committee, the Company is conducting an internal investigation into possible breaches of law, internal corporate policies and codes of conduct as result of continuing investigations by governmental and regulatory authorities in the Republic of Mongolia regarding allegations involving possible breaches of Mongolian law, including anti-corruption and taxation laws. 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. All of these investigations are ongoing but are not yet complete. Information that has been provided to the Mongolian authorities 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.

Meetings of the board and committees of the board

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

During the Financial Year, 15 meetings of the Board of Directors, five (5) meetings of the Audit Committee, nine (9) meetings of the Nominating and Corporate Governance Committee, five (5) meetings of the Compensation and Benefits Committee, three (3) meetings of the Health, Environment, Safety and Social Responsibility Committee and two (2) meetings of the Mergers and Acquisitions Committee were held. Attendance by directors at the Board and Committee meetings is shown below:

Attendance record for the Board and Board Committee meetings during the Financial Year	**Board meetings**	**Audit committee meetings**	**Nominating and Corporate Governance committee meetings**	**Compensation and Benefits committee meetings**	**Health, Environment, Social and Social Responsibility committee meetings**	**Mergers and Acquisitions committee meetings**
	(Number of Attendances/Number of Meetings)					
Executive Directors						
Mr. K. Ross Tromans (1)	1/1	N/A	N/A	N/A	1/1	N/A
Mr. Alexander Molyneux (2)	6/8	N/A	N/A	N/A	2/2	N/A
Non-Executive Directors						
Ms. Kay Priestly *(Chairman)* (3)	8/8	N/A	2/2	N/A	N/A	N/A
Mr. Sean Hinton *(Deputy Chairman)* (4)	7/8	N/A	2/2	N/A	N/A	N/A
Mr. Lindsay Dove (5)	8/8	N/A	N/A	1/1	1/1	N/A
Mr. Kelly Sanders (6)	5/8	N/A	N/A	N/A	1/1	N/A
Mr. Brett Salt (7)	7/8	N/A	N/A	N/A	1/1	N/A
Mr. John Macken (8)	2/3	N/A	N/A	N/A	1/1	N/A
Mr. Peter Meredith (9)	7/8	N/A	N/A	N/A	N/A	N/A
Independent Non-Executive Directors						
Mr. Pierre Lebel *(Lead Director)*	14/15	5/5	9/9	5/5	N/A	2/2
Mr. André Deepwell	15/15	5/5	9/9	5/5	N/A	N/A
Mr. W. Gordon Lancaster (10)	15/15	5/5	9/9	5/5	N/A	1/1
Mr. R. Stuart (Tookie) Angus (11)	4/4	N/A	2/2	2/2	N/A	2/2
Mr. R. Edward Flood (12)	6/8	N/A	4/5	N/A	1/1	2/2
Mr. Robert Hanson (13)	7/8	N/A	4/5	N/A	2/2	N/A

Notes:

(1) Mr. Tromans joined the Board of Directors, the Mergers and Acquisitions and Health, Environment, Safety and Social Responsibility Committees on November 7, 2012.

(2) Mr. Molyneux's employment with the Company ended on September 12, 2012. He also resigned from the Health, Environment, Safety and Social Responsibility Committee at that date.

(3) Ms. Priestly joined the Board of Directors on September 3, 2012 and was appointed to the Nominating and Corporate Governance Committee on November 7, 2012.

(4) Mr. Hinton joined the Board of Directors on September 3, 2012 and was appointed to the Nominating and Corporate Governance Committee on November 7, 2012.

(5) Mr. Dove joined the Board of Directors on September 3, 2012 and was appointed to the Mergers and Acquisitions, Compensation and Benefits, and Health, Environment, Safety and Social Responsibility Committees on November 7, 2012.
(6) Mr. Sanders joined the Board of Directors on September 3, 2012 and was appointed to the Health, Environment, Safety and Social Responsibility Committee on November 7, 2012.
(7) Mr. Salt joined the Board of Directors on September 3, 2012 and was appointed to the Mergers and Acquisitions and Health, Environment, Safety and Social Responsibility Committees on November 7, 2012.
(8) Mr. Macken resigned from the Board of Directors and the Health, Environment, Safety and Social Responsibility Committee on April 17, 2012.
(9) Mr. Meredith resigned from the Board of Directors on September 3, 2012.
(10) Mr. Lancaster joined the Mergers and Acquisitions Committee on March 14, 2012 and resigned on November 7, 2012.
(11) Mr. Angus did not stand for re-election at the Annual General Meeting held on May 17, 2012 and resigned from the Compensation and Benefits, Nominating and Corporate Governance and Mergers and Acquisitions Committees at that time.
(12) Mr. Flood resigned from the Board, the Nominating and Corporate Governance, the Health, Environment, Safety and Social Responsibility and Mergers and Acquisitions Committees on September 3, 2012.
(13) Mr. Hanson resigned from the Board, the Health, Environment, Safety and Social Responsibility and the Nominating and Corporate Governance Committees on September 3, 2012.

The meeting of the shareholders of Company held on May 17, 2012 was attended by Messrs. Deepwell, Lancaster and Lebel. Ms. Priestly and Messrs. Dove, Hinton, Salt, Sanders and Tromans were not members of the Board at the time of this meeting.

Professional development

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

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

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

The Directors participated in a "Duties and Responsibilities for Directors" seminar in 2012 and have the opportunity to attend courses relevant to the Company and its business, particularly with respect to corporate governance and the mining industry, at the Company's expense.

Code of business conduct and ethics

The Company has adopted a Code of Business Conduct and Ethics and Corporate Securities Trading Policy with companion booklet and a Statement of Values and Responsibilities applicable to all employees, consultants, officers and directors regardless of their position in the organization, at all times and everywhere the Company does business. The Code of Business Conduct and Ethics provides that the Company's employees, consultants, officers and directors will uphold its commitment to a culture of honesty, integrity and accountability and the Company requires the highest standards of professional and ethical conduct from its employees, consultants, officers and directors. In 2010 the Company's management created a companion booklet to the Code of Business Conduct and Ethics to provide the Company's directors, employees and consultants with information pertaining to anti-bribery laws in Canada and the U.S. under the Foreign Corrupt Practices Act.

The Company's supervisors, employees and consultants are required to confirm, on an annual basis, that they have received, reviewed and understand the contents and agree to abide by the Company's Code of Business Conduct and Ethics.

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

Appointment and re-election of directors

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

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

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

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

Securities transactions by directors

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

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

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

Remuneration of directors

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

All non-executive directors receive Cdn$25,000 per annum for acting as such. Ms. Priestly, in the capacity of Chairman, and Mr. Lebel, in the capacity of Lead Director, each receive an additional fee of Cdn$60,000 per annum. Mr. Hinton, in the capacity of Deputy Chairman, receives an additional fee of Cdn$45,000 per annum. Mr. Deepwell in the capacity of Chairman of the Audit Committee receives an additional fee of Cdn$40,000 per annum. The Chairs of the Compensation and Benefits Committee, Corporate Governance and Nominating Committee, Mergers and Acquisitions Committee and Health, Environment, Safety and Social Responsibility Committee each receive an additional fee of Cdn$25,000 per annum for acting in such capacity.

Each non-executive director receives a fee of Cdn$1,500 for each Board meeting and each Committee meeting attended in person and Cdn$600 for each conference call meeting in which they participate. Directors also receive a travel allowance of Cdn$2,000 per round-trip in excess of four (4) hours travel time.

In addition to their cash compensation, non-management directors[(1)] also receive a grant of 35,000 stock options per annum, such options having a five-year term and fully vesting on the first anniversary of the date of the grant. To reflect their roles as Lead Director and Chairman of the Audit Committee, Messrs. Lebel and Deepwell each received 40,000 stock options. Messrs. Dove and Hinton each received 50,000 options upon joining the Board.

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

Note:

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

Internal controls

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

The Board conducts annual reviews of the internal controls of the Company to ensure that internal control policies and procedures are adequate. On an ongoing basis, the Directors review the adequacy of the Company's resources, staff qualifications and experience, training programmes and budget of the Company's accounting and financial reporting function. The Audit Committee reviewed the effectiveness of the Company's internal control policies as at December 31, 2012, and is of the view that the internal control system in place is effective in safeguarding the investment of shareholders and assets of the Company.

Auditors

PricewaterhouseCoopers LLP is the auditor of the Company and is independent within the meaning of the Rules of Professional Conduct of the Institute of Chartered Accountants of British Columbia. The financial reporting responsibilities and audit report of the independent auditors are set out on page 95.

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

Fees paid/payable to the external auditors, PricewaterhouseCoopers LLP and Deloitte & Touche LLP (January 1, 2012 to April 2, 2012), in respect of audit and non-audit services provided during the year ended December 31, 2012 are as follows:

Nature of services rendered	Fees paid/payable (US$000's)
Audit fees (a)	420
Non-audit fees (b)	161
Total	**581**

(a) Fees for audit services billed consisted of:
- audit of the Company's annual financial statements.
- reviews of the Company's interim financial statements.

(b) Fees for non-audit services billed consisted of:
- fees for tax services consisting of income tax compliance and tax planning and advice relating to transactions and proposed transactions of the Company and its subsidiaries.
- employee immigration matters and translation services.

Responsibilities in respect of the financial statements

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

Company secretary

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

Shareholders' rights

Under Canadian corporate law, shareholders' rights are governed by the business corporations legislation of the jurisdiction of incorporation of a company and by a company's constating documents. In the case of the Company, the BCBCA and the Articles of the Company govern the rights of shareholders of the Company, as summarized in this section.

How Shareholders can convene an Extraordinary General Meeting

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

On receiving a requisition, directors must call a meeting (subject to certain exceptions) to transact the business stated therein. If notice of the meeting is not sent to holders of Common shares within four (4) months after the date on which the requisition is received by the Company, any shareholder holding, in the aggregate, more than two and a half per cent (2.5%) of the Common shares may send notice of a general meeting to be held to transact the business stated in the requisition. The quorum for the transaction of business at a meeting of shareholders is two (2) holders of Common shares who, in the aggregate, hold at least five per cent (5%) of the Common shares.

Procedures by which enquiries may be put to the Board

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

Procedures for putting forward proposals at shareholders' meetings

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

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

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

SUBSTANTIAL RESOURCE BASE

Substantial resource base established through in-house exploration program

533 million tonnes of measured and indicated and 302 million tonnes of inferred coal resources

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.

Table of contents

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.

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).

1. Overview continued

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, 2013, 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.

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.

1. Overview continued

1.1 Significant events continued

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

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

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

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).

2. Selected annual information continued

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

3.1 Mongolian coal division continued

Regulatory Issues 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.

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.

3. Mineral properties continued

3.1 Mongolian coal division continued

Regulatory Issues continued

Governmental, Regulatory and Internal Investigations 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. 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.

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.

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.

3. Mineral properties continued

3.1 Mongolian coal division continued

Mining Prohibition in Specified Areas Law

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

A draft list of licenses has been prepared that overlap with the prohibited areas described in the new law based on information submitted by water authority agencies, forest authority agencies and local authorities for submission to the Government of Mongolia. In February 2011, the potential 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.

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.

3. Mineral properties continued

3.1 Mongolian coal division continued

Operating Mines continued

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.

	Year ended December 31,	
	2012	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.

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.

3. Mineral properties continued

3.1 Mongolian coal division continued

Operating Mines continued

Select Financial and Operational Data continued

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.

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.

3. Mineral properties continued

3.1 Mongolian coal division continued

Operating Mines continued

Select Financial and Operational Data continued

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.

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.

3. Mineral properties continued

3.1 Mongolian coal division continued

Operating Mines continued

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.

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

3.1 Mongolian coal division continued

Operating Mines 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.

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.

3. Mineral properties continued

3.1 Mongolian coal division continued

Development Projects continued

Soumber Deposit continued

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).

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.

3. Mineral properties continued

3.1 Mongolian coal division continued

Development Projects continued

Zag Suuj Deposit 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 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.

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.

3. Mineral properties continued

3.1 Mongolian coal division continued

Development Projects continued

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.

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

3.1 Mongolian coal division 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.
- 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.

3. Mineral properties continued

3.2 Administrative and other continued

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)

4. Summary of quarterly results continued

($ 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
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.

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.

4. Summary of quarterly results continued

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).
- 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.

	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.

	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

5. Non-IFRS financial measures continued

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.

	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.

6. Liquidity and capital resources continued

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.

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, 2012. 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.

Cash flow highlights

($ in thousands)

	Year ended December 31,	
	2012	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

6. Liquidity and capital resources continued

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.

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:

	As at December 31, 2012			
($ in thousands)	**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

6. Liquidity and capital resources continued

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.

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.

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

6. Liquidity and capital resources continued

Financial instruments continued

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

	As at December 31,	
	2012	2011
Financial assets ($ in thousands)		
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)

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.

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

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

	Year ended December 31,	
($ in thousands)	**2012**	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

8. Related party transactions continued

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.

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.

9. Proposed transaction continued

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.

11. Internal controls over financial reporting continued

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.

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:

12. Critical accounting estimates and judgments continued

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.

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.

12. Critical accounting estimates and judgments continued

Estimated recoverable reserves continued

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.

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.

13. Risk factors continued

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.

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.

13. Risk factors continued

Risks relating to the Company's projects in Mongolia continued

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

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

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

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

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

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.

13. Risk factors continued

Risks relating to the Company's projects in Mongolia continued

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.

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

Risks relating to the Company's projects in Mongolia continued

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

The 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.

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.

13. Risk factors continued

Risks relating to the Company's projects in Mongolia continued

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

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.

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.

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.

13. Risk factors continued

Risks relating to the Company's business and industry continued

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

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

The Ovoot Tolgoi 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.

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.

13. Risk factors continued

Risks relating to the Company's business and industry continued

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

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

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

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

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

13. Risk factors continued

Risks relating to the Company's business and industry continued

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

In 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

Risks relating to the Company's business and industry 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.

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.

13. Risk factors continued

Risks relating to the Company's business and industry continued

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.

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.

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13. Risk factors continued

Risks relating to the Company's business and industry 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.

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.

13. Risk factors continued

Risks relating to the Company's business and industry continued

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

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

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

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

Foreign currency fluctuations could affect expenses and any future earnings.
The Company is exposed to foreign exchange fluctuations with respect to the Mongolian Tugrik, Chinese Renminbi, Hong Kong, Australian and Canadian dollars. The Company's financial results are reported in U.S. dollars. The salaries for local laborers in Mongolia are paid in local currency. Sales of coal into 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.

13. Risk factors continued

Risks relating to the Company's business and industry continued

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.

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.

13. Risk factors continued

Risks relating to the Company's business and industry continued

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.

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 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.
- **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.

COMMITMENT TO THE COMMUNITY

Turning good intentions
into effective results

1

Commitment focused on responsible economic growth, environment, human capital and community

2

Corporate Citizenship Committee ensures strategy is implemented effectively

Consolidated financial statements

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Independent auditor's report

To the Shareholders of SouthGobi Resources Ltd.:

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

Management's responsibility for the consolidated financial statements

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

Auditor's responsibility

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

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

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

Opinion

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

Other matters

The financial statements of the Company for the year ended December 31, 2011, were audited by another auditor who expressed an unmodified opinion on those statements on March 19, 2012.

(signed) PricewaterhouseCoopers LLP

Chartered Accountants

Vancouver, British Columbia
March 25, 2013

Consolidated Statements of Comprehensive Income

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

	Notes	Year ended December 31, 2012	2011
Revenue		**$53,116**	$179,049
Cost of sales	5	**(97,118)**	(127,343)
Gross profit/(loss)		**(44,002)**	51,706
Other operating expenses	6	**(54,345)**	(29,189)
Administration expenses	7	**(24,637)**	(28,749)
Evaluation and exploration expenses	8	**(8,598)**	(31,768)
Loss from operations		**(131,582)**	(38,000)
Finance costs	9	**(15,385)**	(12,765)
Finance income	9	**39,942**	107,732
Share of earnings of joint venture	13	**635**	–
Income/(loss) before tax		**(106,390)**	56,967
Current income tax expense	10	**(354)**	(7,340)
Deferred income tax recovery	10	**3,725**	8,118
Net income/(loss) attributable to equity holders of the Company		**(103,019)**	57,745
OTHER COMPREHENSIVE INCOME/(LOSS)			
Loss on available-for-sale financial asset, net of tax		**–**	(11,202)
Reclassification of gain on available-for-sale financial asset, net of tax		**(16,559)**	–
Net comprehensive income/(loss) attributable to equity holders of the Company		**$(119,578)**	$46,543
BASIC INCOME/(LOSS) PER SHARE	11	**$(0.57)**	$0.32
DILUTED LOSS PER SHARE	11	**$(0.63)**	$(0.19)

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

Consolidated Statements of Financial Position

(expressed in thousands of U.S. Dollars)

	Notes	As at December 31, 2012	2011
ASSETS			
Current assets			
Cash		**$19,674**	$123,567
Trade and other receivables	12	**17,430**	80,285
Short term investments	13	**15,000**	–
Inventories	14	**53,661**	52,443
Prepaid expenses and deposits	15	**37,982**	38,308
Total current assets		**143,747**	294,603
Non-current assets			
Prepaid expenses and deposits	15	**16,778**	8,389
Property, plant and equipment	16	**521,473**	498,533
Long term investments	13	**24,084**	99,238
Deferred income tax assets	10	**23,285**	19,560
Total non-current assets		**585,620**	625,720
Total assets		**$729,367**	$920,323
EQUITY AND LIABILITIES			
Current liabilities			
Trade and other payables	17	**$10,216**	$52,235
Current portion of convertible debenture	19	**6,301**	6,301
Total current liabilities		**16,517**	58,536
Non-current liabilities			
Convertible debenture	19	**99,667**	139,085
Deferred income tax liabilities	10	**–**	2,366
Decommissioning liability	20	**4,104**	4,156
Total non-current liabilities		**103,771**	145,607
Total liabilities		**120,288**	204,143
Equity			
Common shares		**1,059,710**	1,054,298
Share option reserve	23	**51,303**	44,143
Investment revaluation reserve	23	**–**	16,559
Accumulated deficit	21	**(501,934)**	(398,820)
Total equity		**609,079**	716,180
Total equity and liabilities		**$729,367**	$920,323
Net current assets		**$127,230**	$236,067
Total assets less current liabilities		**$712,850**	$861,787

Commitments for expenditure (Note 28) and contingencies (Note 29)

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

APPROVED BY THE BOARD:

"André Deepwell"
Director

"Pierre Lebel"
Director

Consolidated Statements of Changes in Equity

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

	Number of shares	Common shares	Share option reserve	Investment revaluation reserve	Accumulated deficit	Total
Balances, January 1, 2011	183,485	$1,061,560	$32,360	$27,761	$(442,791)	$678,890
Shares issued for:						
Interest settlement on convertible debenture	375	4,011	–	–	–	4,011
Exercise of stock options, net of redemptions	743	7,819	(2,627)	–	–	5,192
Employee share purchase plan	17	187	–	–	–	187
Share-based compensation charged to operations	–	–	14,410	–	–	14,410
Common shares repurchased and cancelled	(3,300)	(19,167)	–	–	(13,774)	(32,941)
Common share repurchase costs	–	(112)	–	–	–	(112)
Net income for the year	–	–	–	–	57,745	57,745
Other comprehensive loss for the year	–	–	–	(11,202)	–	(11,202)
Balances, December 31, 2011	181,320	$1,054,298	$44,143	$16,559	$(398,820)	$716,180
Balances, January 1, 2012	**181,320**	**$1,054,298**	**$44,143**	**$16,559**	**$(398,820)**	**$716,180**
Shares issued for:						
Interest settlement on convertible debenture	**522**	**4,000**	**–**	**–**	**–**	**4,000**
Exercise of stock options, net of redemptions	**163**	**1,882**	**(1,368)**	**–**	**–**	**514**
Employee share purchase plan	**71**	**395**	**–**	**–**	**–**	**395**
Share-based compensation charged to operations	**–**	**–**	**8,528**	**–**	**–**	**8,528**
Common shares repurchased and cancelled	**(148)**	**(860)**	**–**	**–**	**(95)**	**(955)**
Common share repurchase costs	**–**	**(5)**	**–**	**–**	**–**	**(5)**
Net loss for the year	**–**	**–**	**–**	**–**	**(103,019)**	**(103,019)**
Reclassification of gain on available-for-sale financial asset, net of tax	**–**	**–**	**–**	**(16,559)**	**–**	**(16,559)**
Balances, December 31, 2012	**181,928**	**$1,059,710**	**$51,303**	**$–**	**$(501,934)**	**$609,079**

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

Consolidated Statements of Cash Flows

(expressed in thousands of U.S. Dollars)

	Notes	Year ended December 31, 2012	2011
OPERATING ACTIVITIES			
Income/(loss) before tax		**$(106,390)**	$56,967
Adjustments for:			
Depreciation and depletion		**39,935**	28,052
Share-based compensation	22	**8,528**	14,410
Finance costs	9	**15,385**	12,765
Finance income	9	**(39,942)**	(107,732)
Share of earnings of joint venture	13	**(635)**	–
Interest paid		**(16,322)**	(16,352)
Income taxes paid		**(2,349)**	(7,970)
Unrealized foreign exchange gain		**(532)**	(593)
Loss on disposal of property, plant and equipment		**720**	3,005
Provision for doubtful trade and other receivables	12	**18,430**	1,892
Impairment loss on available-for-sale financial asset	13	**19,184**	–
Impairment of inventories	14	**14,196**	2,396
Impairment of property, plant and equipment	16	**15,245**	16,605
Other adjustments		**–**	104
Operating cash flows before changes in non-cash working capital items		**(34,547)**	3,549
Net change in non-cash working capital items	27	**8,264**	(73,572)
Cash used in operating activities		**(26,283)**	(70,023)
INVESTING ACTIVITIES			
Purchase of property, plant and equipment		**(97,388)**	(282,967)
Proceeds from disposal of property, plant and equipment		**1,030**	1,285
Interest received		**400**	1,356
Proceeds from maturity or disposal of long term investments		**31,485**	62,532
Purchase of long term investments		**–**	(52,635)
Investment in joint venture		**(13,264)**	(3)
Cash used in investing activities		**(77,737)**	(270,432)
FINANCING ACTIVITIES			
Proceeds from issuance of common shares and exercise of stock options, net of issue costs		**909**	5,379
Repurchase of common shares, including transaction costs		**(960)**	(33,053)
Drawings under line of credit facility		**26,753**	131,500
Repayments of line of credit facility		**(26,753)**	(131,400)
Cash used in financing activities		**$(51)**	$(27,574)
Effect of foreign exchange rate changes on cash		**178**	(442)
Decrease in cash		**(103,893)**	(368,471)
Cash, beginning of year		**123,567**	492,038
Cash, end of year		**$19,674**	$123,567

Supplemental cash flow information (Note 27)

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

Notes to the Consolidated Financial Statements

December 31, 2012

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

1. Corporate information and liquidity

SouthGobi Resources Ltd. is a publicly listed company incorporated in Canada with limited liability under the legislation of the Province of British Columbia and its shares are listed on the Toronto Stock Exchange (Symbol: SGQ) and Hong Kong Stock Exchange (Symbol: 1878). The company, together with its subsidiaries (collectively referred to as the "Company"), is an integrated coal mining, development and exploration company. The Company owns the following significant coal projects in Mongolia: the Ovoot Tolgoi open pit producing coal mine ("Ovoot Tolgoi Mine") and three development projects, the Soumber Deposit, the Zag Suuj Deposit and the Ovoot Tolgoi Underground Deposit.

The Company's immediate parent company is Turquoise Hill Resources Ltd. (formerly Ivanhoe Mines Ltd.) ("Turquoise Hill") and at December 31, 2012, Turquoise Hill owned approximately 58% of the outstanding common shares of the Company (Note 26). Turquoise Hill is controlled by Rio Tinto plc ("Rio Tinto").

The head office, principal address and registered and records office of the Company is located at 999 Canada Place, Suite 615, Vancouver, British Columbia, Canada, V6C 3E1.

The Company curtailed its mining activities at the Ovoot Tolgoi Mine during the three months ended June 30, 2012 to varying degrees to manage coal inventories and to maintain efficient working capital levels. As at June 30, 2012, mining activities had been fully curtailed. The Company's mining activities remained fully curtailed during the remainder of the year ended December 31, 2012.

The Company had cash and short term investments of $34,674 and working capital of $127,230 at December 31, 2012. These consolidated financial statements have been prepared on a going concern basis which assumes that the Company will continue operating for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of operations as they come due. The Company has in place a planning, budgeting and forecasting process to help determine the funds required to support the Company's normal operations on an ongoing basis and its expansionary plans. The Company 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.

2. Basis of preparation

2.1 Statement of compliance

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

The consolidated financial statements of the Company for the year ended December 31, 2012 were approved and authorized for issue by the Board of Directors of the Company on March 25, 2013.

2.2 Basis of presentation

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

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

2.3 Adoption of new and revised standards and interpretations

The IASB has issued the following new and revised standards and interpretations which are effective for annual periods beginning on or after January 1, 2013. The Company has performed a preliminary assessment of these new and revised standards and interpretations to determine the potential impact on the consolidated financial statements.

- IFRS 10 — New standard to establish principles for the presentation and preparation of consolidated financial statements when an entity controls multiple entities. No significant impact expected on the consolidated financial statements.
- IFRS 11 — New standard to account for the rights and obligations in accordance with a joint arrangement. No significant impact expected on the consolidated financial statements.
- IFRS 12 — New standard for the disclosure of interests in other entities not within the scope of IFRS 9/IAS 39. No significant impact is expected on the consolidated financial statements.
- IFRS 13 — New standard on the measurement and disclosure of fair value. No significant impact is expected on the consolidated financial statements.
- IAS 1 (Amendment) — Revised standard for the presentation of other comprehensive income. No significant impact is expected on the consolidated financial statements.
- IAS 19 (Amendment) — Revised guidance on the recognition and measurement of post-employment benefits. No significant impact is expected on the consolidated financial statements.

2. Basis of preparation continued

2.3 Adoption of new and revised standards and interpretations continued

- IAS 28 (Amendment) — New standard issued that supercedes IAS 28 (2003) to prescribe the accounting for investments in associates and joint ventures. No significant impact is expected on the consolidated financial statements.
- IFRIC 20 — New interpretation to prescribe the accounting for stripping costs in the production phase of a surface mine. The Company has assessed its open-pit mining operations at the Ovoot Tolgoi Mine and concluded that as at January 1, 2012 there are identifiable coal seams with which the predecessor stripping activity related to. Therefore, no significant impact is expected on the consolidated financial statements.

The following new standard is effective for years beginning on or after January 1, 2015. The Company will assess the impact of this new standard closer to its implementation date.

- IFRS 9 — New financial instruments standard that replaces IAS 39 for classification and measurement of financial assets and financial liabilities.

3. Summary of significant accounting policies

3.1 Basis of consolidation

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

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

Non-controlling interests in the net assets of consolidated subsidiaries are identified separately from the Company's equity therein. Total comprehensive income of the Company's subsidiaries is attributed to the equity holders of the Company and to the non-controlling interests even if this results in the non-controlling interest having a deficit balance. The Company did not have any non-controlling interests in the net assets of consolidated subsidiaries during the years ended December 31, 2012 and 2011.

3.2 Business combinations

Acquisitions of businesses are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition date fair value and the amount of any non-controlling interest in the acquiree. At the acquisition date, the identifiable assets acquired and the liabilities assumed are, with limited exceptions, recognized at their fair value. Acquisition-related costs are expensed and included in profit or loss.

3. Summary of significant accounting policies continued

3.2 Business combinations continued

Any contingent consideration payable is recognized at fair value at the acquisition date. If the contingent consideration is classified as equity, it is not remeasured and settlement is accounted for within equity. Otherwise, subsequent changes to the fair value of the contingent consideration are recognized in profit or loss or as a change in other comprehensive income.

Goodwill is initially measured at cost, being the excess of the aggregate of the consideration transferred and the amount recognized for non-controlling interest over the fair value of the identifiable net assets acquired and liabilities assumed. If this consideration is lower than the fair value of the identifiable net assets of the business acquired, the difference is recognized in profit or loss.

3.3 Foreign currencies

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

3.4 Borrowing costs

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

3.5 Inventories

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

Materials and supplies inventory consists of consumable parts and supplies which are valued at the lower of weighted average cost and net realizable value. Supplies used in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost.

3. Summary of significant accounting policies continued

3.6 Property, plant and equipment ("PPE")

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

Initial recognition

The cost of an item of operating equipment and infrastructure consists of the purchase price or construction cost, including vendor prepayments, any costs directly attributable to bringing the asset to the location and condition necessary for its intended use, an initial estimate of the decommissioning liability and capitalized borrowing costs (Note 3.4).

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

All direct costs related to the acquisition of mineral property interests are capitalized on a property by property basis. The cost of mineral properties also includes mineral property development costs (Note 3.7), certain production stripping costs (Note 3.8) and decommissioning liabilities related to the reclamation of the Company's mineral properties.

Depreciation and depletion

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

- Mobile equipment — 5 to 7 years
- Other operating equipment — 1 to 10 years
- Buildings and roads — 5 to 20 years
- Construction in progress — not depreciated
- Mineral properties — unit-of-production basis based on proven and probable reserves (Note 3.7)

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

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

3. Summary of significant accounting policies continued

3.7 Mineral properties

Evaluation and exploration expenses

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

Commencement of commercial production

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

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

3.8 Development and production stripping costs

Stripping costs incurred during the development phase of a mine are added to PPE as mineral property costs. Stripping costs incurred during the commercial production phase are variable production costs that are included in the costs of inventory produced during the period incurred, unless the stripping activity can be shown to give rise to future benefits, in which case the stripping costs are added to the cost of mineral properties.

3.9 Decommissioning, restoration and similar liabilities

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

3. Summary of significant accounting policies continued

3.10 Interests in joint ventures

A joint venture is a contractual arrangement whereby the Company and other parties undertake an economic activity that is subject to joint control. Joint control occurs when the strategic financial and operating policy decisions relating to the activities of the joint venture require unanimous consent of the parties sharing control.

Jointly controlled assets

A jointly controlled asset involves joint control and often joint ownership by the Company and other venturers of assets contributed to, or acquired for the purposes of, the joint venture, without the formation of a corporation, partnership or other entity.

Where the Company's activities are conducted through jointly controlled assets, the Company recognizes its proportionate share of the jointly controlled assets and liabilities it has incurred, its share of liabilities incurred jointly with the other venturers and related revenue and operating costs in the consolidated financial statements.

Jointly controlled entities

A jointly controlled entity is a corporation, partnership or other entity in which each venturer holds an interest.

The Company accounts for its interests in jointly controlled entities under the equity method. The Company's investment in the joint venture is carried in the statement of financial position at cost plus post acquisition changes in the Company's share of the net assets of the joint venture. Goodwill relating to the joint venture is included in the carrying amount of the investment and is neither amortized nor individually tested for impairment.

The profit or loss reflects the Company's share of the results of operations of the joint venture. Unrealized gains and losses resulting from transactions between the Company and the joint venture are eliminated to the extent of the interest in the joint venture.

3.11 Share-based payments

Share-based payment transactions

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

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

3. Summary of significant accounting policies continued

3.11 Share-based payments continued

Equity-settled transactions

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

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

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

3.12 Earnings per share

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

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

3.13 Taxation

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

Current income tax

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

Deferred income tax

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

3. Summary of significant accounting policies continued

3.13 Taxation continued

Deferred income tax continued

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

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

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

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

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

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

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

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

3. Summary of significant accounting policies continued

3.14 Financial assets

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

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

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

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

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

3.15 Financial liabilities

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

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

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

3. Summary of significant accounting policies continued

3.16 Impairment of financial assets

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

Assets carried at amortized cost

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

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

Available-for-sale

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

3.17 Derecognition of financial assets and financial liabilities

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

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

3.18 Impairment of non-financial assets

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

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

3. Summary of significant accounting policies continued

3.18 Impairment of non-financial assets continued

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

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

3.19 Cash and cash equivalents

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

3.20 Revenue recognition

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

Revenue from the sale of coal is recognized when the significant risks and rewards of ownership and effective control of the coal is transferred to the buyer and the selling prices are known or can be reasonably estimated. Revenue recognition generally occurs when the coal is loaded into customer trucks at mine-gate or, depending on the terms of the sales contract, when the coal is made available for loading at a bonded stockyard.

Revenue is presented net of royalties and selling fees.

3.21 Provisions

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

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

3.22 Related party transactions

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

3. Summary of significant accounting policies continued

3.23 Significant accounting judgments and estimates

Information about judgments and estimates in applying accounting policies that have the most significant effect on the amounts recognized in the consolidated financial statements are as follows:

Liquidity and going concern assumption

In the determination of the Company's ability to meet its ongoing obligations and future contractual commitments 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 (refer to Note 1).

Valuation of embedded derivatives

The embedded derivatives in the Company's convertible debenture are valued using a Monte Carlo simulation valuation model. A Monte Carlo simulation model is a valuation model that relies on random sampling and is often used when modeling systems with a large number of inputs and where there is significant uncertainty in the future value of inputs and where the movement of the inputs can be independent of each other. The key inputs used by the Company in its Monte Carlo simulation are further disclosed in Note 19.2 and Note 19.3. Changes in the inputs to the valuation model could impact the carrying value of the embedded derivatives in the convertible debenture and the amount of unrealized gains or losses recognized in profit or loss. The carrying value of the embedded derivatives in the Company's convertible debenture as at December 31, 2012 was a liability of $8,876 (2011: $48,389).

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.

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 $521,473 as at December 31, 2012.

3. Summary of significant accounting policies continued

3.23 Significant accounting judgments and estimates continued

Review of carrying value of assets and impairment charges continued

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.

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.

Income taxes and recoverability of deferred tax assets

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

Judgment is required in determining whether deferred tax assets are recognized on the statement of financial position. Deferred tax assets, including those arising from unutilized tax losses, require management of the Company to assess the likelihood that the Company will generate sufficient taxable profit in future periods in order to utilize recognized deferred tax assets. Estimates of future taxable profit are based on forecast cash flows from operations and the application of existing tax laws in each jurisdiction. To the extent that future cash flows and taxable profit differ from estimates, the ability of the Company to realize the deferred tax assets recorded on the statement of financial position could be impacted. The carrying value of the Company's deferred income tax assets as at December 31, 2012 was $23,285 (2011: $19,560).

4. Segmented information

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

During the year ended December 31, 2012, the Mongolian Coal Division had 6 active customers with the largest customer accounting for 40% of revenues, the second largest customer accounting for 31% of revenue and the other customers accounting for the remaining 29% of revenue.

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

	Mongolian Coal Division	Unallocated(i)	Consolidated Total
Segment assets			
As at December 31, 2012	**$673,896**	**$55,471**	**$729,367**
As at December 31, 2011	696,732	223,591	920,323
Segment liabilities			
As at December 31, 2012	**$11,315**	**$108,973**	**$120,288**
As at December 31, 2011	51,256	152,887	204,143
Segment income/(loss)			
For the year ended December 31, 2012	**$(90,509)**	**$(12,510)**	**$(103,019)**
For the year ended December 31, 2011	(14,043)	71,788	57,745
Segment revenues			
For the year ended December 31, 2012	**$53,116**	**$–**	**$53,116**
For the year ended December 31, 2011	179,049	–	179,049
Impairment charge on assets (ii) (iii)			
For the year ended December 31, 2012	**$47,871**	**$19,184**	**$67,055**
For the year ended December 31, 2011	20,893	–	20,893

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

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

(iii) The impairment charge on assets for the year ended December 31, 2011 relates to trade and other receivables (Note 12), inventories (Note 14) and property, plant and equipment (Note 16)

4. Segmented information continued

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

	Mongolia	Hong Kong	Canada	Consolidated Total
Revenues				
For the year ended December 31, 2012	**$53,116**	**$ –**	**$ –**	**$53,116**
For the year ended December 31, 2011	179,049	–	–	179,049
Non-current assets				
As at December 31, 2012	**$564,930**	**$100**	**$20,591**	**$585,620**
As at December 31, 2011	519,003	283	106,434	625,720

5. Cost of sales

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

	Year ended December 31,	
	2012	2011
Operating expenses	**$22,277**	$97,671
Share-based compensation expense (Note 22)	**1,205**	1,942
Depreciation and depletion	**6,482**	27,730
Impairment of inventories (Note 14)	**14,196**	–
Cost of sales during mine operations	**44,160**	127,343
Cost of sales during idled mine period (i)	**52,958**	–
Cost of sales	**$97,118**	$127,343

(i) Cost of sales during idled mine period for the year ended December 31, 2012 includes $33,358 of depreciation expense and other non-cash costs and $942 of share-based compensation expense. The depreciation expense relates to the Company's idled plant and equipment

6. Other operating expenses

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

	Year ended December 31,	
	2012	2011
Public infrastructure	**$1,273**	$8,069
Sustainability and community relations	**894**	1,017
Foreign exchange (gain)/loss	**2,729**	(790)
Provision for doubtful trade and other receivables (Note 12)	**18,430**	1,892
Impairment loss on available-for-sale financial asset (Note 13)	**19,184**	–
Impairment of inventories (Note 14)	**–**	2,396
Impairment of property, plant and equipment (Note 16)	**15,245**	16,605
Other	**(3,410)**	–
Other operating expenses	**$54,345**	$29,189

7. Administration expenses

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

	Year ended December 31,	
	2012	2011
Corporate administration	**$5,525**	$7,136
Legal and professional fees	**7,293**	4,279
Salaries and benefits	**5,556**	5,538
Share-based compensation expense (Note 22)	**6,048**	11,474
Depreciation	**215**	322
Administration expenses	**$24,637**	$28,749

8. Evaluation and exploration expenses

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

	Year ended December 31,	
	2012	2011
Drilling and trenching	**$3,708**	$21,842
Other direct expenses	**1,428**	4,801
Share-based compensation expense (Note 22)	**333**	994
Overhead and other	**3,129**	4,131
Evaluation and exploration expenses	**$8,598**	$31,768

9. Finance costs and income

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

	Year ended December 31,	
	2012	2011
Interest expense on convertible debenture (Note 19)	**$10,466**	$9,137
Unrealized loss on FVTPL investments	**4,482**	3,091
Interest expense on line of credit facility	**322**	351
Accretion of decommissioning liability	**115**	186
Finance costs	**$15,385**	$12,765

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

	Year ended December 31,	
	2012	2011
Unrealized gain on embedded derivatives in convertible debenture (Note 19)	**$39,512**	$106,489
Interest income	**406**	1,243
Realized gain on disposal of FVTPL investments	**24**	–
Finance income	**$39,942**	$107,732

10. Taxes

10.1 Income tax recognized in profit or loss

A reconciliation between the Company's tax recovery and the product of the Company's income or loss before tax multiplied by the Company's domestic tax rate is as follows:

	Year ended December 31,	
	2012	2011
(Income)/loss before tax	**$106,390**	$(56,967)
Statutory tax rate	**25.00%**	26.50%
Income tax (recovery)/expense based on combined Canadian federal and provincial statutory rates	**(26,598)**	15,096
Deduct:		
Lower effective tax rate in foreign jurisdictions	**323**	502
Tax effect of tax losses and temporary differences not recognized	**15,564**	12,281
Non-taxable (income)/non-deductible expenses	**7,340**	(28,657)
Income tax recovery	**$(3,371)**	$(778)

10.2 Income tax recognized in other comprehensive income

	Year ended December 31,	
	2012	2011
Fair value remeasurement of available-for-sale financial asset	**$(2,366)**	$(1,600)
Deferred tax recovery	**$(2,366)**	$(1,600)

10.3 Deferred tax balances

The Company's deferred tax assets/(liabilities) consist of the following amounts:

	As at December 31,	
	2012	2011
Tax loss carryforwards	**$8,473**	$–
Property, plant and equipment	**5,048**	8,647
Other assets	**9,764**	10,913
Available-for-sale financial assets	**–**	(2,366)
Total deferred tax balances	**$23,285**	$17,194

10.4 Unrecognized deductible temporary differences and unused tax losses

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

	As at December 31,	
	2012	2011
Non-capital losses	**$46,130**	$119,212
Capital losses	**–**	63,649
Deductible temporary differences	**110,945**	107,997
Total unrecognized amounts	**$157,075**	$290,858

10. Taxes continued

10.5 Expiry dates

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

	As at December 31, 2012	
	U.S. Dollar Equivalent	**Expiry dates**
Non-capital losses		
Canada	**$33,715**	2032
Mongolia	**33,892**	2016
Hong Kong	**12,302**	indefinite
Singapore	**113**	indefinite
	$80,022	

11. Earnings/(loss) per share

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

	Year ended December 31,	
	2012	2011
Net income/(loss)	**$(103,019)**	$57,745
Weighted average number of shares	**181,859**	182,970
Basic income/(loss) per share	**$(0.57)**	$0.32
Income/(loss)		
Net income/(loss)	**$(103,019)**	$57,745
Interest expense on convertible debenture	**10,466**	9,137
Unrealized gain on embedded derivatives in convertible debenture	**(39,512)**	(106,489)
Diluted net loss	**$(132,065)**	$(39,607)
Number of shares		
Weighted average number of shares	**181,859**	182,970
Convertible debenture	**28,406**	20,931
Diluted weighted average number of shares	**210,265**	203,901
Diluted loss per share	**$(0.63)**	$(0.19)

Potentially dilutive items not included in the calculation of diluted earnings/(loss) per share for the year ended December 31, 2012 were 7,507 stock options that were anti-dilutive.

12. Trade and other receivables

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

	As at December 31,	
	2012	2011
Trade receivables	**$15,577**	$64,051
VAT/HST receivable	**86**	144
Insurance proceeds receivable	**500**	12,913
Other receivables	**1,267**	3,177
Total trade and other receivables	**$17,430**	$80,285

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

	As at December 31,	
	2012	2011
Less than 1 month	**$2,136**	$50,824
1 to 3 months	**95**	3,337
3 to 6 months	**159**	23,699
Over 6 months	**15,040**	2,425
Total trade and other receivables	**$17,430**	$80,285

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

12.1 Impairment loss provisions

For the year ended December 31, 2012, the Company recorded a $18,430 loss provision on its trade and other receivables in other operating expenses (2011: $1,892). The loss provision relates to provisions for certain uncollectible trade receivables of $17,419 and a reduction in the expected insurance proceeds of $1,011. The Company anticipates full recovery of its remaining outstanding trade and other receivables; therefore, no further loss provisions have been recorded in respect of the Company's trade and other receivables.

13. Investments

The Company's investments consist of the following amounts:

	As at December 31,	
	2012	2011
Short term investments at fair value		
Money market investments (i)	**$15,000**	$–
Long term investments at fair value		
Money market investments (ii)	**–**	44,967
Investment in Kangaroo Resources Limited (iii)	**1,455**	7,431
Investment in Aspire Mining Limited (iv)	**8,727**	46,837
Equity-accounted investment in joint venture		
Investment in RDCC LLC	**13,902**	3
	24,084	99,238
Total short and long term investments	**$39,084**	$99,238

(i) Money market investments with original maturities greater than ninety days and maturing in less than one year
(ii) Money market investments with maturities greater than one year
(iii) At December 31, 2012, the Company owned 1.2% of Kangaroo's issued and outstanding shares
(iv) At December 31, 2012, the Company owned 19.9% of Aspire's issued and outstanding shares

13.1 Investment in Kangaroo Resources Limited

Kangaroo Resources Limited ("Kangaroo") is a company listed on the Australian Stock Exchange. Kangaroo's primary focus is its coal projects in Indonesia. The Company classifies its investment in Kangaroo as a FVTPL financial asset with any change in value being recognized in profit or loss. During the year ended December 31, 2012, the Company disposed of 10,000 shares of Kangaroo for gross proceeds of $1,500 and realized a gain of $39. For the year ended December 31, 2012, the Company recognized an unrealized mark to market loss of $4,515 related to its investment in Kangaroo (2011: loss of $2,804).

13.2 Investment in Aspire Mining Limited

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

During the year ended December 31, 2012, it was determined that objective evidence of impairment in the Company's investment in Aspire existed. Therefore, an impairment loss of $19,184 was recognized for the year ended December 31, 2012 in other operating expenses.

The impairment loss represents the difference between the acquisition cost of the Company's investment in Aspire and its fair market value at December 31, 2012.

13. Investments continued

13.3 Investment in RDCC LLC

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

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

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

	Year ended December 31,	
	2012	2011
Balance, beginning of year	**$3**	$–
Funds advanced	**13,264**	3
Share of earnings of joint venture	**635**	–
Balance, end of year	**$13,902**	$3

Summarized financial statement information of the Company's 40% interest in RDCC LLC is as follows:

	Year ended December 31,	
	2012	2011
Construction revenue	**$8,081**	$–
Gross profit margin	**735**	–
Other operating and finance costs	**(99)**	–
Income before tax	**635**	–
Net income	**$635**	$–

	As at December 31,	
	2012	2011
Current assets	**$740**	$3
Non-current assets	**8,030**	–
Total assets	**$8,770**	$3
Current liabilities	**$39**	$–
Total liabilities	**$39**	$–

14. Inventories

The Company's inventories consist of the following amounts:

	As at December 31,	
	2012	2011
Coal stockpiles	**$9,974**	$6,107
Materials and supplies	**43,687**	46,336
Total inventories	**$53,661**	$52,443

The cost of inventories recognized as an expense for the year ended December 31, 2012 is $19,663 (2011: $116,975). Cost of sales for the year ended December 31, 2012 includes an impairment loss of $14,196 related to the Company's coal stockpile inventories. As at December 31, 2012, the Company's coal stockpile inventories are carried at their net realizable value.

Other operating expenses for the year ended December 31, 2011 includes an impairment loss of $2,396 related to materials and supplies inventories related to the Company's Liebherr 996 shovel and other mobile equipment derecognized during the year ended December 31, 2011.

15. Prepaid expenses and deposits

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

	As at December 31,	
	2012	2011
Vendor prepayments	**$11,628**	$5,754
Ejin Jinda toll coal washing prepayment	**16,778**	25,168
Other prepaid expenses and deposits	**9,576**	7,386
Total short term prepaid expenses and deposits	**37,982**	38,308
Ejin Jinda toll coal washing prepayment	**16,778**	8,389
Total short and long term prepaid expenses and deposits	**$54,760**	$46,697

15.1 Ejin Jinda toll coal washing prepayment

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

Pursuant to the terms of the agreement, the Company prepaid $33,556 of toll coal washing fees of which $16,778 is expected to be applied against toll coal washing fees in 2013, with the remaining $16,778 to be applied against fees in 2014.

16. Property, plant and equipment

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

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

16.1 Borrowing costs

For the year ended December 31, 2012, the Company capitalized borrowing costs of $9,628 into construction in progress (2011: $10,939).

16.2 Prepayments on property, plant and equipment

As at December 31, 2012, the cost of the Company's property, plant and equipment includes $81,370 of prepayments to vendors (2011: $143,377). The prepayments primarily relate to ordered but not yet delivered mobile equipment or mobile equipment delivered to the location of its intended use but not yet commissioned.

16.3 Impairment charges

For the year ended December 31, 2012, the Company recorded $15,245 of impairment charges to reduce various items of property, plant and equipment to their recoverable amounts. The impairments relate to the following items of property, plant and equipment:

- Prepayments on mobile equipment – the Company cancelled certain mobile equipment purchase contracts during the year ended December 31, 2012 to preserve the Company's financial resources. As a result of the purchase contract cancellations, the Company was required to forego $12,978 of non-refundable prepayments made to a vendor which resulted in a corresponding impairment to reduce the carrying amount of mobile equipment.

16. Property, plant and equipment continued

16.3 Impairment charges continued

- Tires held for sale – the Company recorded an impairment provision of $1,141 on certain mobile equipment tires held for sale. The tires were sold during the year end December 31, 2012.
- Construction in progress – various capitalized construction projects were reviewed for impairment and it was determined that certain costs associated with these projects were not expected to be recovered. The Company recorded an impairment charge of $1,126 to reduce the carrying amount of these construction projects to $nil.

For the year ended December 31, 2011, the Company recorded $16,605 of impairment charges, net of insurance proceeds receivable, to reduce various items of property, plant and equipment to their recoverable amounts.

17. Trade and other payables

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

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

	As at December 31,	
	2012	2011
Less than 1 month	**$8,999**	$52,032
1 to 3 months	**176**	76
3 to 6 months	**–**	105
Over 6 months	**1,041**	22
Total trade and other payables	**$10,216**	$52,235

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

18. Line of credit facility

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

The line of credit facility was used by the Company's Mongolian Coal Division as part of its working capital management. 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.

19. Convertible debenture

19.1 Key commercial terms

On November 19, 2009, the Company issued a convertible debenture to a wholly owned subsidiary of the China Investment Corporation ("CIC") for $500,000. The key commercial terms of the financing include:

- Interest – 8% per annum (6.4% payable semi-annually in cash and 1.6% payable annually in the Company's common shares, where the number of shares to be issued is calculated based on the 50-day volume-weighted average price ("VWAP")).
- Term – Maximum of 30 years.
- Security – First charge over the Company's assets, including shares of its material subsidiaries. An event of default on the convertible debenture can be triggered as a result of certain encumbrances on the Company's assets (refer to Note 31.1).
- Conversion price – The conversion price is set as the lower of Cdn$11.88 or the 50-day VWAP at the date of conversion, with a floor price of Cdn$8.88 per share.
- CIC's conversion right – CIC has the right to convert the convertible debenture, in whole or in part, into common shares twelve months after the date of issue.
- Company's normal conversion right – After sixty months from the issuance date, and when the conversion price is greater than Cdn$10.66, the Company is entitled to force conversion of the outstanding convertible debenture, in whole or in part, into common shares at the conversion price.
- Representation on the Company's Board – While the convertible debenture is outstanding, or while CIC has a minimum 15% direct or indirect stake in the Company, CIC has the right to nominate one director to the Company's Board of Directors. The Company currently has nine Board of Directors members of which none were elected by CIC.
- Voting restriction – CIC has agreed that it will not have any voting rights in the Company beyond 29.9% if CIC ever acquires ownership of such a shareholder stake.
- Pre-emption rights – While the convertible debenture is outstanding, or while CIC has a 15% direct or indirect stake in the Company, CIC has certain pre-emption rights on a pro-rata basis to subscribe for any new shares to be allotted and issued by the Company for the period which the convertible debenture is outstanding. The pre-emption rights will not apply to new shares issued pursuant to pro-rata public equity offerings made to all shareholders, exercise of stock options and shares issued to achieve a 25% public float.
- Right of first offer – While a portion of the convertible debenture is outstanding, or while CIC has a 15% direct or indirect stake in the Company, CIC has the right of first offer for any direct and indirect sale of Turquoise Hill's ownership stake in the Company. At December 31, 2012, Turquoise Hill owned directly and indirectly approximately 58% of the Company's issued and outstanding shares.
- Registration rights – CIC has registration rights under applicable Canadian provincial securities laws in connection with the common shares issuable upon conversion of the convertible debenture.

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

19. Convertible debenture continued

19.2 Debt host and embedded derivatives

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

The embedded derivatives were valued upon initial measurement and subsequent periods using a Monte Carlo simulation valuation model. A Monte Carlo simulation model is a valuation model that relies on random sampling and is often used when modeling systems with a large number of inputs and where there is significant uncertainty in the future value of inputs and where the movement of the inputs can be independent of each other. Some of the key inputs used by the Company in its Monte Carlo simulation include: the floor and ceiling conversion prices, the Company's common share price, the risk-free rate of return, expected volatility of the Company's common share price, forward foreign exchange rate curves (between the Cdn$ and U.S. Dollar) and spot foreign exchange rates.

19.3 Valuation assumptions

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

	As at December 31,	
	2012	2011
Floor conversion price	**Cdn$8.88**	Cdn$8.88
Ceiling conversion price	**Cdn$11.88**	Cdn$11.88
Common share price	**Cdn$2.05**	Cdn$6.00
Historical volatility	**70%**	71%
Risk free rate of return	**2.26%**	2.41%
Foreign exchange spot rate (U.S. Dollar to Cdn$)	**1.01**	0.98
Forward foreign exchange rate curve (U.S. Dollar to Cdn$)	**0.96–1.01**	0.96–1.01

19.4 Presentation

Based on the Company's valuation as at December 31, 2012, the fair value of the embedded derivatives decreased by $39,512 compared to December 31, 2011. The decrease was recorded as finance income for the year ended December 31, 2012.

For the year ended December 31, 2012, the Company recorded interest expense of $20,094 (2011: $20,076) related to the convertible debenture of which $9,628 was capitalized as borrowing costs and the remaining $10,466 was recorded as a finance cost. The interest expense consists of the interest at the contract rate and the accretion of the debt host component of the convertible debenture. To calculate the accretion expense, the Company uses the contract life of 30 years and an effective interest rate of 22.2%.

19. Convertible debenture continued

19.4 Presentation continued

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

	Year ended December 31,	
	2012	2011
Balance, beginning of year	**$145,386**	$251,810
Interest expense on convertible debenture	**20,094**	20,076
Decrease in fair value of embedded derivatives	**(39,512)**	(106,489)
Interest paid	**(20,000)**	(20,011)
Balance, end of year	**$105,968**	$145,386

The convertible debenture balance consists of the following amounts:

	As at December 31,	
	2012	2011
Debt host	**$90,791**	$90,696
Fair value of embedded derivatives	**8,876**	48,389
Interest payable	**6,301**	6,301
Convertible debenture	**$105,968**	$145,386

20. Decommissioning liability

At December 31, 2012, the decommissioning liability primarily relates to reclamation and closure costs of the Company's Ovoot Tolgoi Mine.

The Ovoot Tolgoi Mine decommissioning liability is calculated as the net present value of the estimated future reclamation and closure costs, which at December 31, 2012 total $23,577 (2011: $15,211). The estimated future reclamation and closure costs are discounted at 9.6% per annum (2011: 10.5% per annum) to determine the year end decommissioning liability. The settlement of the decommissioning liability will occur through to 2031.

The decommissioning liability transactions during the years ended December 31, 2012 and 2011 were as follows:

	Year ended December 31,	
	2012	2011
Balance, beginning of year	**$4,156**	$3,063
Additions	**(167)**	907
Accretion	**115**	186
Balance, end of year	**$4,104**	$4,156

21. Equity

21.1 Share capital

The Company has authorized an unlimited number of common and preferred shares with no par value. At December 31, 2012, the Company had 181,928 common shares outstanding (2011: 181,364) and no preferred shares outstanding (2011: nil).

During the year ended December 31, 2012, the Company repurchased 148 common shares on the Toronto Stock Exchange and Hong Kong Stock Exchange (2011: 3,300 common shares) at an average price of Cdn$6.44 per share (2011: Cdn$9.98 per share). The share repurchase program concluded on June 14, 2012. The Company cancelled all of the repurchased common shares.

The Company's volume weighted average share price for the year ended December 31, 2012 was Cdn$5.45 (2011: Cdn$11.74).

21.2 Accumulated deficit and dividends

At December 31, 2012, the Company has accumulated a deficit of $501,934 (December 31, 2011: $398,820). No dividends have been paid or declared by the Company since inception.

22. Share-based payments

22.1 Stock option plan

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

For the year ended December 31, 2012, the Company granted 2,066 stock options (2011: 3,493) to officers, employees, directors and other eligible persons at exercise prices ranging from Cdn$1.92 to Cdn$6.16 (2011: exercise prices ranging from Cdn$9.43 to Cdn$14.09) and expiry dates ranging from March 21, 2017 to December 6, 2017 (2011: expiry dates ranging from January 8, 2016 to August 15, 2016). The weighted average fair value of the options granted in the year ended December 31, 2012 was estimated at $2.28 (Cdn$2.26) (2011: $5.59, Cdn$5.47) per option at the grant date using the Black-Scholes option pricing model.

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

	Year ended December 31,	
	2012	2011
Risk free interest rate	**1.51%**	1.66%
Expected life	**3.4 years**	3.5 years
Expected volatility (i)	**59%**	68%
Expected dividend per share	**$nil**	$nil

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

22. Share-based payments continued

22.1 Stock option plan continued

A share-based compensation expense of $4,383 for the options granted in the year ended December 31, 2012 (2011: $18,218) will be amortized over the vesting period, of which $1,905 was recognized in the year ended December 31, 2012 (2011: $6,077).

The total share-based compensation expense recognized for the year ended December 31, 2012 was $8,528 (2011: $14,410). Share-based compensation expense of $6,048 (2011: $11,474) has been allocated to administration expenses, $2,147 (2011: $1,942) has been allocated to cost of sales and $333 (2011: $994) has been allocated to evaluation and exploration expenses.

22.2 Outstanding stock options

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

	Year ended December 31, 2012		Year ended December 31, 2011	
	Number of options	**Weighted average exercise price (Cdn$)**	Number of options	Weighted average exercise price (Cdn$)
Balance, beginning of year	**10,768**	**$10.73**	9,276	$10.82
Options granted	**2,066**	**4.95**	3,493	10.54
Options exercised	**(433)**	**5.81**	(743)	6.89
Options forfeited	**(2,099)**	**9.92**	(1,258)	13.13
Options expired	**(2,795)**	**10.53**	–	–
Balance, end of year	**7,507**	**$9.72**	10,768	$10.73

The stock options outstanding and exercisable as at December 31, 2012 are as follows:

	Options Outstanding			**Options Exercisable**		
Exercise price (Cdn$)	**Options outstanding**	**Weighted average exercise price (Cdn$)**	**Weighted average remaining contractual life (years)**	**Options outstanding and exercisable**	**Weighted average exercise price (Cdn$)**	**Weighted average remaining contractual life (years)**
$1.92 – $6.16	**1,728**	**$4.48**	**3.13**	**619**	**$5.52**	**0.50**
$7.16 – $10.79	**2,752**	**9.16**	**1.66**	**2,190**	**9.08**	**1.18**
$11.51 – $14.25	**2,562**	**12.78**	**1.69**	**2,249**	**12.80**	**1.54**
$15.07 – $18.86	**465**	**15.61**	**0.40**	**465**	**15.61**	**0.40**
	7,507	**$9.72**	**1.93**	**5,523**	**$10.75**	**1.19**

23. Reserves

23.1 Share option reserve

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

The share option reserve transactions for the years ended December 31, 2012 and 2011 are as follows:

	Year ended December 31,	
	2012	2011
Balance, beginning of year	**$44,143**	$32,360
Share-based compensation charged to operations	**8,528**	14,410
Exercise of share options	**(1,368)**	(2,627)
Balance, end of year	**$51,303**	$44,143

23.2 Investment revaluation reserve

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

The investment revaluation reserve transactions for the years ended December 31, 2012 and 2011 are as follows:

	Year ended December 31,	
	2012	2011
Balance, beginning of year	**$16,559**	$27,761
Loss arising on revaluation of available-for-sale financial asset	**(35,034)**	(12,802)
Deferred income tax relating to revaluation of available-for-sale financial asset	**2,366**	1,600
Reclassification of impairment loss on available-for-sale financial asset	**16,109**	–
Balance, end of year	**$–**	$16,559

24. Capital risk management

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

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

24. Capital risk management continued

At December 31, 2012, the Company's capital structure consists of convertible debt (Note 19) and the equity of the Company (Note 21). The Company is not subject to any externally imposed capital requirements. In order to maximize ongoing development efforts, the Company does not pay dividends.

For the year ended December 31, 2012, there were no significant changes in the processes used by the Company or in the Company's objectives and policies for managing its capital. As at December 31, 2012, the Company had cash and short term investments of $34,674 and working capital of $127,230.

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.

25. Financial instruments

25.1 Categories of financial instruments

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

	As at December 31,	
	2012	2011
Financial assets		
Loans-and-receivables		
Cash	**$19,674**	$123,567
Trade and other receivables (Note 12)	**17,430**	80,285
Available-for-sale		
Investment in Aspire (Note 13)	**8,727**	46,837
Fair value through profit or loss		
Investment in Kangaroo (Note 13)	**1,455**	7,431
Money market investments (Note 13)	**15,000**	44,967
Total financial assets	**$62,286**	$303,087
Financial liabilities		
Fair value through profit or loss		
Convertible debenture – embedded derivatives (Note 19)	**$8,876**	$48,389
Other-financial-liabilities		
Trade and other payables (Note 17)	**10,216**	52,235
Convertible debenture – debt host (Note 19)	**97,092**	96,997
Total financial liabilities	**$116,184**	$197,621

25. Financial instruments continued

25.2 Fair value

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

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

- The fair value of financial instruments that are traded on an active liquid market are determined with reference to the quoted market prices. The fair value of the Company's investment in the shares of Kangaroo, shares of Aspire and its money market investments are determined using this methodology.
- The fair value of financial instruments that are not traded in an active market are determined using generally accepted valuation models using inputs that are directly (i.e. prices) or indirectly (i.e. derived from prices) observable. The fair value of the embedded derivatives within the convertible debenture (Note 19) is determined using a Monte Carlo simulation. None of the fair value change in the embedded derivatives for the year ended December 31, 2012 is related to a change in the credit risk of the convertible debenture. All of the change in fair value is associated with changes in market conditions.

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

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

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

	Level 1	Level 2	Total
Financial assets at fair value			
Investment in Aspire	$8,727	$–	$8,727
Investment in Kangaroo	1,455	–	1,455
Money market investments	15,000	–	15,000
Total financial assets at fair value	$25,182	$–	$25,182
Financial liabilities at fair value			
Convertible debenture – embedded derivatives	$–	$8,876	$8,876
Total financial liabilities at fair value	$–	$8,876	$8,876

There were no transfers between Level 1, 2 and 3 for the year ended December 31, 2012.

25. Financial instruments continued

25.3 Financial risk management objectives and policies

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

Currency risk

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

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

	As at December 31,	
	2012	2011
Increase/decrease in foreign exchange rate		
+5%	**$850**	$4,414
−5%	**$(850)**	$(4,414)

Interest rate risk

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

The Company's convertible debenture (Note 19) and line of credit facility (Note 18) accrue interest at fixed rates; therefore the Company is not exposed to interest rate risk on these instruments.

Credit risk

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

The Company's credit risk on cash and short term money market investments arises from default of the counterparty. The Company limits its exposure to counterparty credit risk on these assets by only dealing with financial institutions with high credit ratings.

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

25. Financial instruments continued

25.3 Financial risk management objectives and policies continued

Liquidity risk

Liquidity risk is the risk that the Company will not be able to settle or manage its obligations associated with financial liabilities. The Board of Directors of the Company is of the opinion that the Company has 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.

The Company's current and expected remaining contractual maturities for its financial liabilities with agreed repayment periods are as follows. Refer to Note 31.1 for details of events occurring subsequent to December 31, 2012 related to the Company's convertible debenture. The table includes the undiscounted cash flows of financial liabilities based on the earliest date on which the Company can be required to satisfy the liabilities.

	0 to 6 months	6 to 12 months	1 to 5 years	Total
As at December 31, 2012				
Trade and other payables	**$10,216**	**$–**	**$–**	**$10,216**
Convertible debenture – cash interest (Note 19) [(i)]	**8,000**	**8,000**	**16,000**	**32,000**
	$18,216	**$8,000**	**$16,000**	**$42,216**
As at December 31, 2011				
Trade and other payables	$52,235	$–	$–	$52,235
Convertible debenture – cash interest (Note 19) [(i)]	8,000	8,000	32,000	48,000
	$60,235	$8,000	$32,000	$100,235

(i) The convertible debenture cash interest payments presented assume that the convertible debenture is converted in to common shares by the Company on November 19, 2014 (refer to Note 19)

Commodity price risk

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

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

26. Related party transactions

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

Name	Country of incorporation	% equity interest As at December 31, 2012	2011
SouthGobi Resources (Hong Kong) Limited	Hong Kong	**100%**	100%
SouthGobi Sands LLC	Mongolia	**100%**	100%
SGQ Coal Investment Pte. Ltd.	Singapore	**100%**	100%

During the year ended December 31, 2012 and 2011, the Company had related party transactions with the following companies related by way of directors or shareholders in common:

- Turquoise Hill – Turquoise Hill is the Company's immediate parent company and at 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 – 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.

26. Related party transactions continued

26.1 Related party expenses

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

	Year ended December 31,	
	2012	2011
Corporate administration	**$1,309**	$1,990
Salaries and benefits	**919**	1,389
Related party expenses	**$2,228**	$3,379

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

	Year ended December 31,	
	2012	2011
GMM	**$1,012**	$2,014
Turquoise Hill	**7**	94
Rio Tinto	**68**	–
I2MS	**1,141**	1,271
Related party expenses	**$2,228**	$3,379

26.2 Related party expense recoveries

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

	Year ended December 31,	
	2012	2011
Corporate administration	**$589**	$465

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

	Year ended December 31,	
	2012	2011
Turquoise Hill	**$479**	$311
Ivanhoe Energy	**77**	154
Rio Tinto	**33**	–
Related party expense recoveries	**$589**	$465

26. Related party transactions continued

26.3 Related party assets

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

	Year ended December 31,	
	2012	2011
Amounts due from GMM	**$420**	$539
Amounts due from Turquoise Hill	**317**	26
Amounts due from Ivanhoe Energy	**–**	13
Amounts due from I2MS	**2**	–
Total assets due from related parties	**$739**	$578

26.4 Related party liabilities

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

	As at December 31,	
	2012	2011
Amounts payable to GMM	**$–**	$255
Amounts payable to Rio Tinto	**35**	–
Amounts payable to I2MS	**–**	189
Total liabilities due to related parties	**$35**	$444

26.5 Key management personnel compensation

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

	Year ended December 31,	
	2012	2011
Salaries, fees and other benefits	**$3,788**	$3,493
Share-based compensation	**2,132**	9,147
Total remuneration	**$5,920**	$12,640

27. Supplemental cash flow information

27.1 Non-cash financing and investing activities

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

	Year ended December 31,	
	2012	2011
Interest settlement on convertible debenture	**$4,000**	$4,011
Transfer of share option reserve upon exercise of options	**$1,368**	$2,627

27.2 Net change in non-cash working capital items

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

	Year ended December 31,	
	2012	2011
Decrease/(increase) in inventories	**$2,509**	$(27,672)
Decrease/(increase) in trade and other receivables	**39,709**	(49,550)
Increase in prepaid expenses and deposits	**(8,064)**	(36,433)
Increase/(decrease) in trade and other payables	**(25,890)**	40,083
Net change in non-cash working capital items	**$8,264**	$(73,572)

28. Commitments for expenditure

As at December 31, 2012, the Company's commitments for expenditure that have not been disclosed elsewhere in the consolidated financial statements are as follows:

	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

29. Contingencies

29.1 Governmental, regulatory and internal investigations

The Company is subject to continuing investigations by the Mongolian Independent Authority Against Corruption ("IAAC") and other governmental and regulatory authorities in the Republic of Mongolia regarding allegations against the Company and some of its employees involving possible breaches of Mongolian laws, including anti-corruption and taxation laws.

Neither the Company 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), the Company 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.

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

In the opinion of management of the Company, at December 31, 2012 a provision for this matter is not required.

30. Proportional takeover bid

On April 2, 2012, the Company announced 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 the Company at Cdn$8.48 per share ("Proportional Offer"). The Company 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. CHALCO's obligations under the cooperation agreement were to become effective upon CHALCO acquiring a shareholding in the Company.

30. Proportional takeover bid continued

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

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

On September 3, 2012, the Company was notified that CHALCO's Proportional Offer had been terminated, which also resulted in the termination of the cooperation agreement.

31. Subsequent events

31.1 Mongolian IAAC investigation

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 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 convertible debenture terms. However, in the event that the orders result in an event of default of the Company's 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.

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.

31.2 CIC convertible debenture share interest payment and application of Mongolian Foreign Investment Law

On May 17, 2012, the Parliament of Mongolia approved a Foreign Investment Law that regulates foreign direct investment into a number of key sectors of strategic importance, which includes mineral resources. If foreign shareholding exceeds 49% of an asset and the amount of the investment at the time is to exceed 100 billion Mongolian Tugriks (approximately $71,500), then parliamentary approval is required. In the case of state owned entities there is no minimum threshold and all proposed investments from state owned entities 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 100 billion Mongolian Tugrik threshold is not applicable and cabinet approval for the investment is required regardless of the value.

The terms of the convertible debenture provide for the 1.6% share interest payment of $4,000 to be paid annually in common shares of the Company. As a result of the Foreign Investment Law, the Company expected it would require parliamentary approval for the shares to be issued for the November 19, 2012 share interest payment. Subsequent to December 31, 2012, the Company settled the 1.6% share interest payment of $4,000 in cash.

Appendix to the consolidated financial statements

December 31, 2012

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

Additional stock exchange information

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

A1. Income/(loss) for the year

Income/(loss) for the year has been arrived at after charging the following items:

	Year ended December 31,	
	2012	2011
Auditor's remuneration	**$420**	$275
Loss on disposal of property, plant and equipment	**$720**	$3,005
Depreciation and depletion		
Depreciation included in administration expenses	**$212**	$322
Depreciation included in evaluation and exploration expenses	**40**	–
Depreciation and depletion included in cost of sales	**39,705**	27,730
Total depreciation and depletion	**$39,957**	$28,052
Staff costs		
Directors' emoluments – executive directors (Note A2)	**$1,183**	$2,928
Directors' emoluments – non-executive directors (Note A2)	**1,366**	1,900
Other staff costs	**9,055**	12,184
Staff costs included in administration expenses	**11,604**	17,012
Staff costs included in evaluation and exploration expenses	**437**	1,155
Total staff costs	**$12,041**	$18,167

A2. Director and employee emoluments

Directors' emoluments

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

	Year ended December 31,	
	2012	2011
Directors' fees	**$719**	$421
Other emoluments for executive and non-executive directors		
Salaries and other benefits	**799**	926
Share-based compensation	**1,031**	3,481
Directors' emoluments	**$2,549**	$4,828

A2. Director and employee emoluments continued

Directors' emoluments continued

Year ended December 31, 2012

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

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

Year ended December 31, 2011

Name of director	Directors' fees	Salaries and other benefits	Share-based compensation	Total
Executive directors				
Alexander Molyneux	$–	$926	$2,002	$2,928
Non-executive directors				
Peter Meredith	$–	$–	$286	$286
John Macken	–	–	167	167
Pierre Lebel	110	–	191	301
André Deepwell	88	–	167	255
R. Edward Flood	42	–	167	209
R. Stuart (Tookie) Angus	70	–	167	237
Robert Hanson	64	–	167	231
W. Gordon Lancaster	47	–	167	214
	$421	$–	$1,479	$1,900
Directors' emoluments	$421	$926	$3,481	$4,828

Salaries and other benefits paid to Alexander Molyneux during the year ended December 31, 2011 includes a bonus of $425 paid in accordance with the Company's annual incentive plans.

A2. Director and employee emoluments continued

Five highest paid individuals

The five highest paid individuals included one director of the Company for the years ended December 31, 2012 and 2011. The emoluments of the five highest paid individuals are as follows:

	Year ended December 31,	
	2012	2011
Salaries and other benefits	**$2,571**	$2,754
Share-based compensation	**1,743**	9,066
Compensation for loss of office	**424**	–
Total emoluments	**$4,738**	$11,820

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

	Year ended December 31,	
	2012	2011
HK$ 4,500,001 to HK$ 5,000,000	**1**	–
HK$ 6,500,001 to HK$ 7,000,000	**1**	1
HK$ 7,000,001 to HK$ 7,500,000	**1**	–
HK$ 8,000,001 to HK$ 8,500,000	**1**	–
HK$ 9,500,001 to HK$ 10,000,000	**1**	–
HK$ 15,000,001 to HK$ 15,500,000	**–**	1
HK$ 21,000,001 to HK$ 21,500,000	**–**	1
HK$ 22,500,001 to HK$ 23,000,000	**–**	1
HK$ 25,000,001 to HK$ 25,500,000	**–**	1
	5	5

A3. Five year summary

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

	Year ended December 31,				
	2012	2011	2010	2009	2008
Revenue	**$53,116**	$179,049	$79,777	$36,038	$3,126
Gross profit/(loss)	**(44,002)**	51,706	9,873	6,613	949
Net comprehensive income/(loss) attributable to equity holders of the Company	**$(119,578)**	$46,543	$(88,434)	$(110,805)	$(69,576)
Basic income/(loss) per share from continuing and discontinued operations	**$(0.57)**	$0.32	$(0.66)	$(0.83)	$(0.54)
Diluted loss per share from continuing and discontinued operations	**$(0.63)**	$(0.19)	$(0.66)	$(0.83)	$(0.54)

	As at December 31,				
	2012	2011	2010	2009	2008
Total assets	**$729,367**	$920,323	$961,866	$560,684	$99,948
Less: total liabilities	**(120,288)**	(204,143)	(282,976)	(563,476)	(10,984)
Total net assets/(liabilities)	**$609,079**	$716,180	$678,890	$(2,792)	$88,964

A4. Share repurchases

During the year ended December 31, 2012, the Company repurchased its own shares on the Toronto Stock Exchange and Hong Kong Stock Exchange as follows:

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

As at December 31, 2012, the Company had cancelled all of the repurchased common shares. None of the Company's subsidiaries repurchased, sold or redeemed any of the Company's shares during the year ended December 31, 2012.

A5. Cash

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

	As at December 31,	
	2012	2011
Denominated in U.S. Dollars	**$18,107**	$114,941
Denominated in Hong Kong Dollars	**396**	3,757
Denominated in Canadian Dollars	**260**	3,027
Denominated in Mongolian Tugriks	**911**	1,440
Others	**–**	402
Total cash	**$19,674**	$123,567

Corporate information

Directors

Executive Directors:

Mr. K. Ross Tromans

Non-Executive Directors:

Ms. Kay Priestly (Chairman)
Mr. Sean Hinton (Deputy Chairman)
Mr. Lindsay Dove
Mr. Brett Salt
Mr. Kelly Sanders

Independent Non-Executive Directors:

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

Audit committee

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

Nominating and corporate governance committee

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

Compensation and benefits committee

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

Health, environment, safety and social responsibility committee

Mr. Kelly Sanders (Chair)
Mr. Lindsay Dove
Mr. Brett Salt
Mr. K. Ross Tromans

Mergers and acquisitions committee

Mr. Lindsay Dove (Chair)
Mr. Pierre Lebel
Mr. Brett Salt
Mr. K. Ross Tromans

Company secretary

Ms. Allison Snetsinger

Registered office

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Wan Chai, Hong Kong

Principal bankers

Canada:

BMO Bank of Montreal

Hong Kong:

Standard Chartered Bank (Hong Kong) Limited

Principal share registrar

Canadian Stock Transfer Company Inc.
as agent for CIBC Mellon Trust Company
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Canada V6E 3X1

Branch share registrar

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

Independent auditor

PricewaterhouseCoopers LLP

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FSC™ C010883

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