SouthGobi Resources Ltd.
CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
June 30, 2013
(Unaudited)
(Expressed in U.S. Dollars)

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

		Three months ended June 30,		Six months ended June 30,	
	Notes	**2013**	**2012**	**2013**	**2012**
Revenue		**$ 374**	$ 8,412	**$ 3,633**	$ 48,565
Cost of sales	4	**(12,466)**	(22,221)	**(34,327)**	(39,700)
Gross profit/(loss)		**(12,092)**	(13,809)	**(30,694)**	8,865
Other operating expenses	5	**(14,877)**	(3,803)	**(15,260)**	(6,380)
Administration expenses	6	**(4,024)**	(7,497)	**(7,757)**	(13,380)
Evaluation and exploration expenses	7	**(221)**	(2,099)	**(494)**	(7,132)
Loss from operations		**(31,214)**	(27,208)	**(54,205)**	(18,027)
Finance costs	8	**(5,617)**	(4,006)	**(10,608)**	(4,681)
Finance income	8	**3,366**	26,875	**4,136**	26,290
Share of earnings of joint venture	11	**44**	204	**27**	204
Income/(loss) before tax		**(33,421)**	(4,135)	**(60,650)**	3,786
Current income tax recovery/(expense)		**-**	3,747	**(1)**	(1,127)
Deferred income tax recovery/(expense)		**(241)**	625	**2,087**	704
Net income/(loss) attributable to equity holders of the Company		**(33,662)**	237	**(58,564)**	3,363
OTHER COMPREHENSIVE LOSS					
Items that may be reclassified to profit or loss:					
Loss on available-for-sale financial asset, net of tax	11	**(930)**	(20,087)	**-**	(25,509)
Net comprehensive loss attributable to equity holders of the Company		**$ (34,592)**	$ (19,850)	**$ (58,564)**	$ (22,146)
BASIC INCOME/(LOSS) PER SHARE	9	**$ (0.18)**	$ 0.00	**$ (0.32)**	$ 0.02
DILUTED LOSS PER SHARE	9	**$ (0.18)**	$ (0.12)	**$ (0.32)**	$ (0.10)

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

SOUTHGOBI RESOURCES LTD.

Condensed Consolidated Interim Statements of Financial Position

(Unaudited)

(Expressed in thousands of U.S. Dollars)

	Notes	As at June 30, 2013	As at December 31, 2012
ASSETS			
Current assets			
Cash		**$ 19,171**	$ 19,674
Trade and other receivables	10	**7,947**	17,430
Short term investments	11	**-**	15,000
Inventories	12	**45,872**	53,661
Prepaid expenses and deposits		**33,467**	37,982
Total current assets		**106,457**	143,747
Non-current assets			
Prepaid expenses and deposits		**16,778**	16,778
Property, plant and equipment	13	**508,734**	521,473
Long term investments	11	**21,887**	24,084
Deferred income tax assets		**25,372**	23,285
Total non-current assets		**572,771**	585,620
Total assets		**$ 679,228**	$ 729,367
EQUITY AND LIABILITIES			
Current liabilities			
Trade and other payables	14	**$ 16,184**	$ 10,216
Current portion of convertible debenture	15	**12,278**	6,301
Total current liabilities		**28,462**	16,517
Non-current liabilities			
Convertible debenture	15	**95,631**	99,667
Decommissioning liability		**4,406**	4,104
Total non-current liabilities		**100,037**	103,771
Total liabilities		**128,499**	120,288
Equity			
Common shares		**1,059,791**	1,059,710
Share option reserve		**51,436**	51,303
Accumulated deficit	16	**(560,498)**	(501,934)
Total equity		**550,729**	609,079
Total equity and liabilities		**$ 679,228**	$ 729,367
Net current assets		**$ 77,995**	$ 127,230
Total assets less current liabilities		**$ 650,766**	$ 712,850

Commitments for expenditure (Note 21) and contingencies (Note 22)

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

APPROVED BY THE BOARD:

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

SOUTHGOBI RESOURCES LTD.

Condensed Consolidated Interim Statements of Changes in Equity

(Unaudited)

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

	Number of shares	Common shares	Share option reserve	Investment revaluation reserve	Accumulated deficit	Total
Balances, January 1, 2012	181,320	$ 1,054,298	$ 44,143	$ 16,559	$ (398,820)	$ 716,180
Shares issued for:						
Interest settlement on convertible debenture	522	4,000	-	-	-	4,000
Exercise of stock options, net of redemptions	163	1,882	(1,368)	-	-	514
Employee share purchase plan	30	212	-	-	-	212
Share-based compensation charged to operations	-	-	8,182	-	-	8,182
Common shares repurchased and cancelled	(148)	(860)	-	-	(95)	(955)
Common share repurchase costs	-	(5)	-	-	-	(5)
Net income for the period	-	-	-	-	3,363	3,363
Other comprehensive loss for the period	-	-	-	(25,509)	-	(25,509)
Balances, June 30, 2012	181,887	$ 1,059,527	$ 50,957	$ (8,950)	$ (395,552)	$ 705,982
Balances, January 1, 2013	**181,928**	**$1,059,710**	**$ 51,303**	**$ -**	**$ (501,934)**	**$ 609,079**
Shares issued for:						
Employee share purchase plan	**38**	**81**	**-**	**-**	**-**	**81**
Share-based compensation charged to operations	**-**	**-**	**133**	**-**	**-**	**133**
Net loss for the period	**-**	**-**	**-**	**-**	**(58,564)**	**(58,564)**
Balances, June 30, 2013	**181,966**	**$1,059,791**	**$ 51,436**	**$ -**	**$ (560,498)**	**$ 550,729**

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

SOUTHGOBI RESOURCES LTD.

Condensed Consolidated Interim Statements of Cash Flows

(Unaudited)

(Expressed in thousands of U.S. Dollars)

	Notes	Six months ended June 30, 2013	2012
OPERATING ACTIVITIES			
Income/(loss) before tax		**$ (60,650)**	$ 3,786
Adjustments for:			
Depreciation and depletion		**17,164**	14,273
Share-based compensation	17	**133**	8,182
Finance costs	8	**10,608**	4,681
Finance income	8	**(4,136)**	(26,290)
Share of earnings of joint venture	11	**(27)**	(204)
Interest paid		**(4,011)**	(8,130)
Income taxes paid		**-**	(2,349)
Loss on disposal of property, plant and equipment		**623**	-
Unrealized foreign exchange gain		**(26)**	(511)
Provision for doubtful trade and other receivables		**-**	2,583
Impairment loss on available-for-sale financial asset	11	**3,067**	-
Impairment of inventories	12	**13,065**	-
Impairment of property, plant and equipment	13	**4,299**	-
Other adjustments		**16**	342
Operating cash flows before changes in non-cash working capital items		**(19,875)**	(3,637)
Net change in non-cash working capital items	20	**12,682**	4,809
Cash generated from/(used in) operating activities		**(7,193)**	1,172
INVESTING ACTIVITIES			
Expenditures on property, plant and equipment		**(7,979)**	(73,102)
Proceeds from disposal of property, plant and equipment		**717**	-
Interest received		**74**	247
Proceeds from maturity or disposal of short and long term investments		**15,226**	16,500
Investment in joint venture		**(1,579)**	(6,450)
Cash generated from/(used in) investing activities		**6,459**	(62,805)
FINANCING ACTIVITIES			
Proceeds from issuance of common shares and exercise of stock options, net of issue costs		**81**	726
Repurchase of common shares, including transaction costs		**-**	(960)
Drawings under line of credit facility		**-**	17,053
Repayments of line of credit facility		**-**	(17,327)
Cash generated from/(used in) financing activities		**81**	(508)
Effect of foreign exchange rate changes on cash		**150**	152
Decrease in cash		**(503)**	(61,989)
Cash, beginning of period		**19,674**	123,567
Cash, end of period		**$ 19,171**	$ 61,578

Supplemental cash flow information (Note 20)

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

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 June 30, 2013, Turquoise Hill owned approximately 58% of the outstanding common shares of the Company (Note 19). 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 until March 22, 2013, when the Company recommenced mining activities at the Ovoot Tolgoi Mine.

The Company had cash of $19,171 and working capital of $77,995 at June 30, 2013. These condensed consolidated interim 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, including the interest payments due on the China Investment Corporation ("CIC") convertible debenture (Note 15), for at least twelve months from the end of the June 30, 2013 reporting period. The Company expects its liquidity to remain sufficient based on existing capital resources and estimated income from mining operations. Estimated income from mining operations is subject to a number of external market factors including supply and demand and pricing in the coal industry. 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

These condensed consolidated interim financial statements, including comparatives, have been prepared in accordance with International Accounting Standard 34 "Interim Financial Reporting" ("IAS 34") using accounting policies 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 ("IFRIC").

The condensed consolidated interim financial statements of the Company for the six months ended June 30, 2013 were approved and authorized for issue by the Board of Directors of the Company on August 12, 2013.

2.2 Basis of presentation

These condensed consolidated interim financial statements have been prepared using accounting policies and methods of computation consistent with those applied in the Company's December 31, 2012 consolidated annual financial statements, except for those accounting policies which have changed as a result of the adoption of new and revised standards and interpretations as described below. These condensed consolidated interim financial statements do not include all the information and note disclosures required by IFRS for annual financial statements and therefore should be read in conjunction with the Company's annual consolidated financial statements for the year ended December 31, 2012.

2.3 Adoption of new and revised standards and interpretations

The Company has adopted the new and revised standards and interpretations issued by the IASB listed below effective January 1, 2013. These changes were made in accordance with the transitional provisions outlined in the respective standards and interpretations.

IFRS 10 Consolidated Financial Statements

IFRS 10 replaces IAS 27 "Consolidated and Separate Financial Statements" and SIC 12 "Consolidation – Special Purpose Entities". IFRS 10 establishes principles for the presentation and preparation of consolidated financial statements when an entity controls multiple entities. The new consolidation standard changes the definition of control so that the same criteria apply to all entities, both operating and special purpose entities, to determine control. The revised definition focuses on the need to have both power over the investee and exposure to variable returns before control is present. The adoption of IFRS 10 did not result in any change in the consolidation status of any of the Company's subsidiaries and investees.

2. BASIS OF PREPARATION (Continued)

2.3 Adoption of new and revised standards and interpretations (Continued)

IFRS 11 Joint Arrangements

IFRS 11 replaces IAS 31 "Interests in Joint Ventures". IFRS 11 classifies joint arrangements as either joint operations or joint ventures, depending on the rights and obligations of the parties involved in the joint arrangement. Joint arrangements that are classified as joint operations require the venturers to recognize the individual assets, liabilities, revenues and expenses to which they have legal rights or are responsible. Joint arrangements that are classified as a joint venture are accounted for using the equity method of accounting.

As a result of the adoption of IFRS 11, the Company's 40% interest in RDCC LLC is now classified as a joint venture (previously classified as a jointly-controlled entity under IAS 31). Prior to the adoption of IFRS 11, the Company accounted for its investment in RDCC LLC under the equity method of accounting. Therefore, the adoption of IFRS 11 did not have an impact on the consolidated financial statements for the current or prior periods presented.

IFRS 12 Disclosure of Interests in Other Entities

IFRS 12 outlines the disclosure requirements for interests in subsidiaries and other entities. The adoption of IFRS 12 will result in incremental disclosures in the Company's consolidated annual financial statements.

IFRS 13 Fair Value Measurement

IFRS 13 provides a definition of fair value, sets out a single IFRS framework for measuring fair value and outlines disclosure requirements for fair value measurements. The adoption of IFRS 13 has resulted in additional fair value measurement disclosures in these condensed consolidated interim financial statements (refer to Note 18) and will result in incremental disclosures in the Company's annual consolidated financial statements.

IAS 1 Presentation of Financial Statements (Amendment)

The amendments to IAS 1 requires companies preparing financial statements under IFRS to group items within other comprehensive income that may be reclassified to profit or loss and those that will not be reclassified. The consolidated statement of comprehensive income in these condensed consolidated interim financial statements has been amended to reflect the presentation requirements under the amended IAS 1.

2. BASIS OF PREPARATION (Continued)

2.3 Adoption of new and revised standards and interpretations (Continued)

IFRIC 20 Stripping Costs in the Production Phase of a Surface Mine

IFRIC 20 provides guidance on the accounting for the costs of stripping activities during the production phase of a surface mine. Under IFRIC 20, stripping activity assets are recognized when the following three criteria are met:

- it is probable that the future economic benefit (improved access to the ore body) associated with the stripping activity will flow to the entity;
- the entity can identify the component of the ore body for which access has been improved; and
- the costs relating to the stripping activity associated with that component can be measured reliably

If not all of the criteria are met, the stripping activity costs are included in the costs of inventory produced during the period incurred.

The Company assessed its open-pit mining operations at the Ovoot Tolgoi Mine and concluded that as at January 1, 2012 there are identifiable coal seams with which the predecessor stripping activity related to. Therefore, no adjustment to the consolidated financial statements was required upon initial transition to IFRIC 20.

The adoption of IFRIC 20 has not resulted in a change in the Company's capitalization of stripping activity costs, and therefore no adjustment was required to the Company's consolidated financial statements in the current or prior periods presented. The Company classifies stripping activity assets capitalized under IFRIC 20 as mineral property costs within property, plant and equipment and these costs are amortized on a units-of-production basis based on proven and probable reserves.

Other

The IASB also amended IAS 19 "Post-Employment Benefits" and IAS 28 "Investments in Associates" (2003) effective January 1, 2013. The amendments to these standards did not impact the Company's consolidated financial statements.

IFRS 9 "Financial Instruments" is effective for years beginning on or after January 1, 2015. The IASB issued IFRS 9 as the first step in its project to replace IAS 39 "Financial Instruments: Recognition and Measurement". The Company will assess the impact of this new standard closer to its implementation date.

2. BASIS OF PREPARATION (Continued)

2.4 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 Company's consolidated financial statements are included in Note 3.23 to the Company's December 31, 2012 consolidated annual financial statements. Except for the significant accounting judgments and estimates disclosed below, the significant accounting judgments and estimates remain unchanged from December 31, 2012.

Review of carrying value of assets and impairment charges

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

During the three months ended June 30, 2013, the Company determined that an indicator of impairment existed for its property, plant and equipment related to the Ovoot Tolgoi Mine. The impairment indicator was the continued weakness in the Company's share price.

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 June 30, 2013. The Company's property, plant and equipment, including mineral properties, totaled $508,734 as at June 30, 2013.

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 June 30, 2013. The Company believes that the estimates and assumptions incorporated in the impairment analysis are reasonable; however, the estimates and assumptions are subject to significant uncertainties and judgments.

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

3. SEGMENTED INFORMATION

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

During the six months ended June 30, 2013, the Mongolian Coal Division had 4 active customers with the largest customer accounting for 85% of revenues, the second largest customer accounting for 7% of revenue and the other customer accounting for the remaining 8% 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 June 30, 2013	**$ 644,407**	**$ 34,821**	**$ 679,228**
As at December 31, 2012	673,896	55,471	729,367
Segment liabilities			
As at June 30, 2013	**$ 14,693**	**$ 113,806**	**$ 128,499**
As at December 31, 2012	11,315	108,973	120,288
Segment income/(loss)			
For the three months ended June 30, 2013	**$ (25,876)**	**$ (7,786)**	**$ (33,662)**
For the three months ended June 30, 2012	(18,872)	19,109	237
For the six months ended June 30, 2013	**$ (43,721)**	**$ (14,842)**	**$ (58,563)**
For the six months ended June 30, 2012	(7,108)	10,471	3,363
Segment revenues			
For the three months ended June 30, 2013	**$ 374**	**$ -**	**$ 374**
For the three months ended June 30, 2012	8,412	-	8,412
For the six months ended June 30, 2013	**$ 3,633**	**$ -**	**$ 3,633**
For the six months ended June 30, 2012	48,565	-	48,565
Impairment charge on assets (ii)			
For the three months ended June 30, 2013	**$ 15,202**	**$ 3,067**	**$ 18,269**
For the three months ended June 30, 2012	2,583	-	2,583
For the six months ended June 30, 2013	**$ 17,364**	**$ 3,067**	**$ 20,431**
For the six months ended June 30, 2012	2,583	-	2,583

(i) The unallocated amount contains all amounts associated with the Corporate Division.
(ii) The impairment charge on assets for the three and six months ended June 30, 2013 and 2012 relates to trade and other receivables, investments (Note 11), inventories (Note 12) and property, plant and equipment (Note 13).

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

3. SEGMENTED INFORMATION (Continued)

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

	Mongolia	Hong Kong	Canada	Consolidated Total
Revenues				
For the three months ended June 30, 2013	**$ 374**	**$ -**	**$ -**	**$ 374**
For the three months ended June 30, 2012	8,412	-	-	8,412
For the six months ended June 30, 2013	**$ 3,633**	**$ -**	**$ -**	**$ 3,633**
For the six months ended June 30, 2012	48,565	-	-	48,565
Non-current assets				
As at June 30, 2013	**$ 555,901**	**$ 82**	**$ 16,788**	**$ 572,771**
As at December 31, 2012	564,930	100	20,590	585,620

4. COST OF SALES

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

	Three months ended June 30,		Six months ended June 30,	
	2013	**2012**	**2013**	**2012**
Operating expenses	**$ 2,777**	$ 4,975	**$ 5,899**	$ 17,567
Share-based compensation expense (Note 17)	**(153)**	189	**(153)**	1,205
Depreciation and depletion	**114**	1,470	**278**	5,341
Impairment of coal stockpile inventories (Note 12)	**3,973**	-	**6,135**	-
Cost of sales from mine operations	**6,711**	6,634	**12,159**	24,113
Cost of sales related to idled mine assets (i)	**5,755**	15,587	**22,168**	15,587
Cost of sales	**$ 12,466**	$ 22,221	**$ 34,327**	$ 39,700

(i) Cost of sales related to idled mine assets for the three months ended June 30, 2013 includes $5,716 of depreciation expense and other non-cash costs and $nil share-based compensation expense. Cost of sales related to idled mine assets for the six months ended June 30, 2013 includes $16,872 of depreciation expense and other non-cash costs and $nil share-based compensation expense. Cost of sales related to idled mine assets for the three and six months ended June 30, 2012 includes $8,785 of depreciation expense and other non-cash costs and $965 of share-based compensation expense.

The 2012 idled mine asset depreciation expense and other non-cash costs relates to the Company's idled plant and equipment during the full curtailment of its mining activities at the Ovoot Tolgoi Mine during the three months ended June 30, 2012. The 2013 idled mine asset depreciation expense and other non-cash costs relates to the Company's idled plant and equipment as the 2013 production plan does not fully utilize the Company's existing mining fleet.

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

5. OTHER OPERATING EXPENSES

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

	Three months ended June 30,		Six months ended June 30,	
	2013	**2012**	**2013**	**2012**
Public infrastructure	**$ 3**	$ 1,176	**$ 6**	$ 1,186
Sustainability and community relations	**34**	260	**80**	431
Foreign exchange (gain)/loss	**(22)**	(483)	**296**	1,960
Loss on disposal of property, plant and equipment	**566**	-	**566**	-
Provision for doubtful trade and other receivables	**-**	2,583	**-**	2,583
Impairment loss on available-for-sale financial asset (Note 11)	**3,067**	-	**3,067**	-
Impairment of materials and supplies inventories (Note 12)	**6,930**	-	**6,930**	-
Impairment of property, plant and equipment (Note 13)	**4,299**	-	**4,299**	-
Other	**-**	267	**16**	220
Other operating expenses	**$ 14,877**	$ 3,803	**$ 15,260**	$ 6,380

6. ADMINISTRATION EXPENSES

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

	Three months ended June 30,		Six months ended June 30,	
	2013	**2012**	**2013**	**2012**
Corporate administration	**$ 992**	$ 1,544	**$ 2,124**	$ 3,033
Legal and professional fees	**2,229**	1,338	**3,631**	1,682
Salaries and benefits	**643**	1,508	**1,607**	2,857
Share-based compensation expense (Note 17)	**126**	3,052	**274**	5,698
Depreciation	**34**	55	**121**	110
Administration expenses	**$ 4,024**	$ 7,497	**$ 7,757**	$ 13,380

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

7. EVALUATION AND EXPLORATION EXPENSES

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

	Three months ended June 30,		Six months ended June 30,	
	2013	**2012**	**2013**	**2012**
Drilling and trenching	**$ -**	$ 696	**$ -**	$ 3,470
Other direct expenses	**9**	259	**29**	587
License fees	**166**	199	**346**	405
Share-based compensation expense (Note 17)	**6**	177	**12**	314
Overhead and other	**40**	768	**107**	2,356
Evaluation and exploration expenses	**$ 221**	$ 2,099	**$ 494**	$ 7,132

8. FINANCE COSTS AND INCOME

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

	Three months ended, June 30,		Six months ended, June 30,	
	2013	**2012**	**2013**	**2012**
Interest expense on convertible debenture	**5,073**	1,552	**10,031**	1,816
Interest expense on line of credit facility	**-**	99	**11**	187
Unrealized loss on FVTPL investments (i)	**473**	2,282	**468**	2,620
Realized loss on disposal of FVTPL investments (Note 11)	**43**	46	**43**	-
Accretion of decommissioning liability	**28**	27	**55**	58
Finance costs	**$ 5,617**	$ 4,006	**$ 10,608**	$ 4,681

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

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

	Three months ended, June 30,		Six months ended, June 30,	
	2013	**2012**	**2013**	**2012**
Unrealized gain on embedded derivatives in convertible debenture (Note 15)	**$ 3,343**	$ 26,770	**$ 4,091**	$ 25,995
Interest income	**23**	105	**45**	256
Realized gain on disposal of investments	**-**	-	**-**	39
Finance income	**$ 3,366**	$ 26,875	**$ 4,136**	$ 26,290

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

9. EARNINGS/(LOSS) PER SHARE

	Three months ended June 30,		Six months ended June 30,	
	2013	**2012**	**2013**	**2012**
Net income/(loss)	**$ (33,662)**	$ 237	**$ (58,564)**	$ 3,363
Weighted average number of shares	**181,963**	181,860	**181,954**	181,802
Basic income/(loss) per share	**$ (0.18)**	$ 0.00	**$ (0.32)**	$ 0.02
Income/(loss)				
Net income/(loss)	**$ (33,662)**	$ 237	**$ (58,564)**	$ 3,363
Interest expense on convertible debenture	**-**	1,552	**-**	1,816
Unrealized gain on embedded derivatives in convertible debenture	**-**	(26,770)	**-**	(25,995)
Diluted net loss	**$ (33,662)**	$ (24,981)	**$ (58,564)**	$ (20,816)
Number of shares				
Weighted average number of shares	**181,963**	181,860	**181,954**	181,802
Convertible debenture (i)	**-**	28,128	**-**	28,406
Diluted weighted average number of shares	**181,963**	209,988	**181,954**	210,208
Diluted loss per share	**$ (0.18)**	$ (0.12)	**$ (0.32)**	$ (0.10)

(i) The convertible debenture was anti-dilutive for the three and six months ended June 30, 2013.

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

Potentially dilutive items not included in the calculation of diluted earnings/(loss) per share for the three and six months ended June 30, 2013 were 3,145 and 3,106 stock options, respectively, that were anti-dilutive.

10. TRADE AND OTHER RECEIVABLES

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

	As at	
	June 30, 2013	**December 31, 2012**
Trade receivables	**$ 7,134**	$ 15,577
Other receivables	**813**	1,853
Total trade and other receivables	**$ 7,947**	$ 17,430

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

10. TRADE AND OTHER RECEIVABLES (Continued)

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

	As at	
	June 30, 2013	December 31, 2012
Less than 1 month	$ 71	$ 2,135
1 to 3 months	23	95
3 to 6 months	6	159
Over 6 months	7,847	15,041
Total trade and other receivables	$ 7,947	$ 17,430

Included in trade and other receivables are amounts due from related parties which are further disclosed in Note 19.

The Company anticipates full recovery of its outstanding trade and other receivables; therefore, no loss provisions have been recorded in respect of the Company's trade and other receivables.

11. INVESTMENTS

The Company's investments consist of the following amounts:

	As at	
	June 30, 2013	December 31, 2012
Short term investments at fair value		
Money market investments (i)	$ -	$ 15,000
Long term investments at fair value		
Investment in Kangaroo Resources Limited (ii)	718	1,455
Investment in Aspire Mining Limited (iii)	5,661	8,727
Investment in joint venture		
Investment in RDCC LLC	15,508	13,902
	21,887	24,084
Total short and long term investments	$ 21,887	$ 39,084

(i) Money market investments with original maturities greater than ninety days and maturing in less than one year.
(ii) At June 30, 2013, the Company owned 1.0% of Kangaroo Resources Limited's issued and outstanding common shares.
(iii) At June 30, 2013, the Company owned 18.8% of Aspire Mining Limited's issued and outstanding common shares.

11. INVESTMENTS (Continued)

11.1 Investment in Kangaroo Resources Limited

Kangaroo Resources Limited ("Kangaroo") is a company listed on the Australian Stock Exchange. Kangaroo's primary focus is its coal projects in Indonesia. The Company classifies its investment in Kangaroo as a FVTPL financial asset with any change in value being recognized in profit or loss. During the three and six months ended June 30, 2013, the Company disposed of 7,365 shares of Kangaroo for gross proceeds of $226 and realized a loss of $43.

11.2 Investment in Aspire Mining Limited

Aspire Mining Limited ("Aspire") is a company listed on the Australian Stock Exchange. Aspire's primary focus is its mineral exploration 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. For the three and six months ended June 30, 2013, the Company recognized an impairment loss of $3,067 in other operating expenses related to its investment in Aspire. For the three and six months ended June 30, 2012, the Company recognized unrealized losses, net of tax, of $20,087 and $25,509, respectively, in other comprehensive income related to its investment in Aspire.

11.3 Investment in RDCC LLC

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

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

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

11. INVESTMENTS (Continued)

11.3 Investment in RDCC LLC (Continued)

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

	Three months ended June 30,		Six months ended June 30,	
	2013	**2012**	**2013**	**2012**
Balance, beginning of period	**$ 15,300**	$ 216	**$ 13,902**	$ 3
Funds advanced	**164**	6,237	**1,579**	6,450
Share of earnings of joint venture	**44**	204	**27**	204
Balance, end of period	**$ 15,508**	$ 6,657	**$ 15,508**	$ 6,657

For the three and six months ended June 30, 2013, RDCC LLC recognized construction revenue of $1,476 (2012: $7,075) with a profit margin of $134 (2012: $634) related to the construction of the paved highway.

For the three and six months ended June 30, 2013, RDCC LLC had net earnings of $109 and $68, respectively. For the three and six months ended June 30, 2012, RDCC LLC had net earnings of $509.

12. INVENTORIES

The Company's inventories consist of the following amounts:

	As at	
	June 30, 2013	**December 31, 2012**
Coal stockpiles	**$ 8,357**	$ 9,974
Materials and supplies	**37,515**	43,687
Total inventories	**$ 45,872**	$ 53,661

Cost of sales for the three and six months ended June 30, 2013 included impairment losses of $3,973 and $6,135, respectively, related to the Company's coal stockpile inventories. As at June 30, 2013, the Company's coal stockpile inventories are carried at their net realizable value.

Other operating expenses for the three and six months ended June 30, 2013 includes an impairment loss of $6,930 related to surplus materials and supplies inventories not expected to be utilized with the Company's existing mining fleet.

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

13. PROPERTY, PLANT AND EQUIPMENT

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

	Mobile equipment	Other operating equipment	Buildings and roads	Mineral properties	Construction in progress	Total
Cost						
As at December 31, 2012	$ 352,040	$ 28,044	$ 69,923	$ 116,083	$ 55,912	$ 622,001
Additions and adjustments	**2,038**	**96**	**2,122**	**13,042**	**40**	**17,338**
Disposals	**(2,184)**	**(481)**	**-**	**-**	**-**	**(2,665)**
As at June 30, 2013	**$ 351,894**	**$ 27,659**	**$ 72,045**	**$ 129,125**	**$ 55,952**	**$ 636,674**
Accumulated depreciation						
As at December 31, 2012	$ (79,400)	$ (7,359)	$ (9,299)	$ (4,470)	$ -	$ (100,528)
Charge for the period	**(18,780)**	**(2,315)**	**(3,265)**	**(78)**	**-**	**(24,438)**
Impairment charges	**(4,299)**	**-**	**-**	**-**	**-**	**(4,299)**
Eliminated on disposals	**875**	**450**	**-**	**-**	**-**	**1,325**
As at June 30, 2013	**$ (101,604)**	**$ (9,224)**	**$ (12,564)**	**$ (4,548)**	**$ -**	**$ (127,940)**
Carrying amount						
As at December 31, 2012	$ 272,640	$ 20,684	$ 60,624	$ 111,613	$ 55,912	$ 521,473
As at June 30, 2013	**$ 250,290**	**$ 18,434**	**$ 59,481**	**$ 124,577**	**$ 55,952**	**$ 508,734**

13.1 Borrowing costs

For the three and six months ended June 30, 2013, the Company capitalized borrowing costs of $nil into construction in progress. For the three and six months ended June 30, 2012, the Company capitalized borrowing costs of $3,437 and $8,168, respectively.

13.2 Prepayments on property, plant and equipment

As at June 30, 2013, the cost of the Company's property, plant and equipment includes $47,421 of prepayments to vendors (December 31, 2012: $81,370). The prepayments primarily relate to ordered but not yet delivered mobile equipment or mobile equipment delivered to the location of its intended use but not yet commissioned.

13.3 Impairment charges

For the three and six months ended June 30, 2013, the Company recorded $4,299 of impairment charges to reduce various items of property, plant and equipment to their recoverable amounts. The impairments relate to surplus capital spares not expected to be utilized with the Company's existing mining fleet.

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

14. 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	
	June 30, 2013	**December 31, 2012**
Less than 1 month	**$ 14,658**	$ 8,999
1 to 3 months	**341**	176
3 to 6 months	**153**	-
Over 6 months	**1,032**	1,041
Total trade and other payables	**$ 16,184**	$ 10,216

Included in trade and other payables are amounts due to related parties which are further disclosed in Note 19.

15. CONVERTIBLE DEBENTURE

15.1 Debt host and embedded derivatives

On November 19, 2009, the Company issued a convertible debenture to a wholly owned subsidiary of the CIC for $500,000. The convertible debenture bears interest at 8.0% per annum (6.4% payable semi-annually in cash and 1.6% payable annually in the Company's shares) and has a maximum term of 30 years. The convertible debenture is secured by a first charge over the Company's assets, including shares of its material subsidiaries. An event of default on the convertible debenture can be triggered as a result of certain encumbrances on the Company's assets (refer to Note 22.2).

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

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

15. CONVERTIBLE DEBENTURE (Continued)

15.1 Debt host and embedded derivatives (Continued)

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.

15.2 Valuation assumptions

The assumptions used in the Company's valuation models as at June 30, 2013 and December 31, 2012 are as follows:

	As at	
	June 30, 2013	**December 31, 2012**
Floor conversion price	**Cdn$8.88**	Cdn$8.88
Ceiling conversion price	**Cdn$11.88**	Cdn$11.88
Common share price	**Cdn$1.24**	Cdn$2.05
Historical volatility	**69%**	70%
Risk free rate of return	**2.84%**	2.26%
Foreign exchange spot rate (Cdn$ to U.S. Dollar)	**0.95**	1.01
Forward foreign exchange rate curve (Cdn$ to U.S. Dollar)	**0.92 - 0.95**	0.96- 1.01

15.3 Presentation

Based on the Company's valuations as at June 30, 2013, the fair values of the embedded derivatives decreased by $3,343 and $4,091 compared to March 31, 2013 and December 31, 2012, respectively. The decreases were recorded as finance income for the three and six months ended June 30, 2013.

For the three months ended June 30, 2013, the Company recorded interest expense of $5,073 (2012: $4,989) related to the convertible debenture of which $nil (2012: $3,437) was capitalized as borrowing costs. For the six months ended June 30, 2013, the Company recorded interest expense of $10,031 (2012: $9,984) related to the convertible debenture of which $nil (2012: $8,168) was capitalized as borrowing costs.

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

15. CONVERTIBLE DEBENTURE (Continued)

15.3 Presentation (Continued)

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

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

	Three months ended June 30,		Six months ended June 30,	
	2013	**2012**	**2013**	**2012**
Balance, beginning of period	**$ 106,179**	$ 147,156	**$ 105,969**	$ 145,386
Interest expense on convertible debenture	**5,073**	4,989	**10,031**	9,984
Decrease in fair value of embedded derivatives	**(3,343)**	(26,770)	**(4,091)**	(25,995)
Interest paid	**-**	(7,957)	**(4,000)**	(11,957)
Balance, end of period	**$ 107,909**	$ 117,418	**$ 107,909**	$ 117,418

During the three months ended June 30, 2013, the Company and the CIC mutually agreed upon a three month deferral of the convertible debenture semi-annual $7,934 cash interest payment due on May 19, 2013. The $7,934 cash interest payment is now due on August 19, 2013. The mutually agreed upon deferral of the cash interest payment did not trigger an event of default and all other terms of the convertible debenture remain unchanged.

The convertible debenture balance consists of the following amounts:

	As at	
	June 30, 2013	**December 31, 2012**
Debt host	**$ 90,845**	$ 90,791
Fair value of embedded derivatives	**4,786**	8,876
Interest payable	**12,278**	6,301
Convertible debenture	**$ 107,909**	$ 105,968

15. CONVERTIBLE DEBENTURE (Continued)

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

On May 17, 2012, the Parliament of Mongolia approved a Law on Regulation of Foreign Investment in Business Entities Operating in Sectors of Strategic Importance ("Foreign Investment Law") that regulates foreign direct investment into a number of key sectors of strategic importance, which includes mineral resources. Prior to the amendments in the three months ended June 30, 2013, if foreign shareholding exceeded 49% of an asset and the amount of the investment at the time exceeds 100 billion Mongolian Tugriks (approximately $69,000), then parliamentary approval was required. In the case of state owned entities there was no minimum threshold and all proposed investments from state owned entities required parliamentary approval. In addition, if a foreign entity wanted to acquire one third or more of the shares in an investment in a strategic sector, then the 100 billion Mongolian Tugrik threshold was not applicable and cabinet approval for the investment was required regardless of the value.

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

Following amendments to the Foreign Investment Law, passed in the three months ended June 30, 2013, the requirement for parliamentary approval has been limited to circumstances where a state owned entity is to exceed 49% share ownership of a strategic asset, irrespective of the amount of investment. As a result, the Company understands that it will now only require cabinet approval, rather than parliamentary approval, under the Foreign Investment Law for the 1.6% share interest payment to the CIC. The Company will fully comply with the requirements of the Foreign Investment Law in connection with share interest payments.

16. EQUITY

16.1 Share capital

The Company has authorized an unlimited number of common and preferred shares with no par value. At June 30, 2013, the Company had 181,966 common shares outstanding (December 31, 2012: 181,928) and no preferred shares outstanding (December 31, 2012: nil).

During the six months ended June 30, 2012, the Company repurchased 148 common shares at an average price of Cdn$6.47 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 six months ended June 30, 2013 was Cdn$2.08 (2012: Cdn$6.48).

16.2 Accumulated deficit and dividends

At June 30, 2013, the Company has accumulated a deficit of $560,498 (December 31, 2012: $501,934). No dividends have been paid or declared by the Company since inception.

17. SHARE-BASED PAYMENTS

17.1 Stock option plan

The Company has a stock option plan which permits the Board of Directors of the Company to grant options to acquire common shares of the Company at the volume weighted average closing price for the five days preceding the date of grant. The Company is authorized to issue stock options for a maximum of 10% of the issued and outstanding common shares pursuant to the stock option plan.

For the six months ended June 30, 2013, the Company granted 62 stock options (2012: 1,475) to officers, employees, directors and other eligible persons at an exercise price of Cdn$2.10 (2012: exercise price of Cdn$6.16) and an expiry date of March 27, 2018 (2012: expiry date of March 21, 2017). The weighted average fair value of the options granted in the six months ended June 30, 2013 was estimated at $0.76 (Cdn$0.78) (2012: $2.87, Cdn$2.85) per option at the grant date using the Black-Scholes option pricing model.

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

17. SHARE-BASED PAYMENTS (Continued)

17.1 Stock option plan (Continued)

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

	Six months ended June 30,	
	2013	**2012**
Risk free interest rate	**1.20%**	1.62%
Expected life	**3 years**	3.5 years
Expected volatility (i)	**58%**	60%
Expected dividend per share	**$nil**	$nil

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

A share-based compensation expense of $44 for the options granted in the six months ended June 30, 2013 (2012: $3,950) will be amortized over the vesting period, of which $11 was recognized in the six months ended June 30, 2013 (2012: $668).

The total share-based compensation recognized for the three months ended June 30, 2013 was a recovery of $21 (2012: $4,383 expense). Share-based compensation expense of $126 (2012: $3,052 expense) has been allocated to administration expenses, a recovery of $153 (2012: $1,154 expense) has been allocated to cost of sales and an expense of $6 (2012: $177 expense) has been allocated to evaluation and exploration expenses.

The total share-based compensation recognized for the six months ended June 30, 2013 was an expense of $133 (2012: $8,182). Share-based compensation expense of $274 (2012: $5,698 expense) has been allocated to administration expenses, a recovery of $153 (2012: $2,170 expense) has been allocated to cost of sales and an expense of $12 (2012: $314 expense) has been allocated to evaluation and exploration expenses.

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

17. SHARE-BASED PAYMENTS (Continued)

17.2 Outstanding stock options

The option transactions under the stock option plan for the six months ended June 30, 2013 and 2012 are as follows:

	Six months ended June 30, 2013			**Six months ended June 30, 2012**		
	Number of options		Weighted average exercise price (Cdn$)	Number of options		Weighted average exercise price (Cdn$)
Balance, beginning of year	**7,507**	**$**	**9.72**	10,768	$	10.73
Options granted	**62**		**2.10**	1,475		6.16
Options excercised	**-**		**-**	(433)		5.81
Options forfeited	**(398)**		**7.53**	(380)		10.89
Options expired	**(4,026)**		**10.53**	(456)		5.95
Balance, end of year	**3,145**	**$**	**8.81**	10,974	$	10.50

The stock options outstanding and exercisable as at June 30, 2013 are as follows:

	Options Outstanding				**Options Exercisable**			
Exercise price (Cdn$)	Options outstanding		Weighted average exercise price (Cdn$)	Weighted average remaining contractual life (years)	Options outstanding and exercisable		Weighted average exercise price (Cdn$)	Weighted average remaining contractual life (years)
1.92 to 6.16	**1,135**	**$**	**3.92**	**3.60**	**342**	**$**	**5.64**	**2.09**
9.43 to 10.21	**830**		**9.54**	**2.83**	**428**		**9.61**	**2.62**
11.51 to 18.86	**1,180**		**12.99**	**1.80**	**972**		**13.10**	**1.71**
	3,145	**$**	**8.81**	**2.72**	**1,742**	**$**	**10.78**	**2.01**

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

18. FAIR VALUE MEASUREMENTS

Certain of the Company's financial assets and liabilities are measured at fair value on a recurring basis. The following table provides an analysis of the Company's financial assets and liabilities 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 June 30, 2013 and December 31, 2012, the Company did not have any financial assets or liabilities measured using Level 3 inputs.

As at June 30, 2013	Level 1	Level 2	Total
Financial assets at fair value			
Investment in Aspire	$ 5,661	$ -	$ 5,661
Investment in Kangaroo	718	-	718
Total financial assets at fair value	$ 6,379	$ -	$ 6,379
Financial liabilities at fair value			
Convertible debenture - embedded derivatives [(i)]	$ -	$ 4,786	$ 4,786
Total financial liabilities at fair value	$ -	$ 4,786	$ 4,786

(i) The assumptions used in the Company's valuation models as at June 30, 2013 and December 31, 2012 are further disclosed in Note 15.2.

As at December 31, 2012	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 six months ended June 30, 2013.

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

19. RELATED PARTY TRANSACTIONS

During the six months ended June 30, 2013 and 2012, the Company had related party transactions with the following companies related by way of directors or shareholders in common:

- Turquoise Hill – Turquoise Hill is the Company's immediate parent company and at June 30, 2013 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 June 30, 2013 Rio Tinto controlled Turquoise Hill. The Company recovers administration and other costs incurred on behalf of Rio Tinto on a cost-recovery basis. Rio Tinto recovers from the Company the costs of salaries and benefits of employees assigned to work for the Company.
- Global Mining Management ("GMM") – GMM is a private company owned equally by seven companies, two of which include the Company and Turquoise Hill. GMM provides administration, accounting and other office services to the Company on a cost-recovery basis.
- 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 in 2012 had two directors in common with the Company. The Company provided some office and investor relations services to Ivanhoe Energy in the Company's Hong Kong office and recovered the costs for those services on a cost-recovery basis. The Company's provision of office and investor relations services to Ivanhoe Energy ceased on June 30, 2012.

19.1 Related party expenses

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

	Three months ended June 30,		Six months ended June 30,	
	2013	**2012**	**2013**	**2012**
Corporate administration	**$ 227**	$ 479	**$ 380**	$ 847
Salaries and benefits	**296**	245	**483**	571
Related party expenses	**$ 523**	$ 724	**$ 863**	$ 1,418

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

19. RELATED PARTY TRANSACTIONS (Continued)

19.1 Related party expenses (Continued)

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

	Three months ended June 30,		Six months ended June 30,	
	2013	**2012**	**2013**	**2012**
GMM	**$ 5**	$ 286	**$ 57**	$ 717
Turquoise Hill	**62**	23	**99**	27
Rio Tinto	**276**	-	**390**	-
I2MS	**180**	415	**317**	674
Related party expenses	**$ 523**	$ 724	**$ 863**	$ 1,418

19.2 Related party expense recoveries

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

	Three months ended June 30,		Six months ended June 30,	
	2013	**2012**	**2013**	**2012**
Corporate administration	**$ -**	$ 248	**$ 7**	$ 512

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

	Three months ended June 30,		Six months ended June 30,	
	2013	**2012**	**2013**	**2012**
Turquoise Hill	**$ -**	$ 210	**$ -**	$ 435
Ivanhoe Energy	**-**	38	**-**	77
Rio Tinto	**-**	-	**7**	-
Related party expense recoveries	**$ -**	$ 248	**$ 7**	$ 512

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

19. RELATED PARTY TRANSACTIONS (Continued)

19.3 Related party assets

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

	As at	
	June 30, 2013	**December 31, 2012**
Amounts due from GMM	**$ 116**	$ 420
Amounts due from Turquoise Hill	**65**	317
Amounts due from I2MS	**-**	2
Total assets due from related parties	**$ 181**	$ 739

19.4 Related party liabilities

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

	As at	
	June 30, 2013	**December 31, 2012**
Amounts payable to Rio Tinto	**$ 368**	$ -
Amounts payable to I2MS	**131**	35
Total liabilities due to related parties	**$ 499**	$ 35

20. SUPPLEMENTAL CASH FLOW INFORMATION

20.1 Non-cash financing and investing activities

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

	Six months ended June 30,	
	2013	**2012**
Convertible debenture interest settlement in shares	**$ -**	$ 4,000
Tranfer of share option reserve upon exercise of stock options	**-**	1,368

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

20. SUPPLEMENTAL CASH FLOW INFORMATION (Continued)

20.2 Net change in non-cash working capital items

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

	Six months ended June 30, 2013	Six months ended June 30, 2012
Increase in inventories	**$ (2,696)**	$ (7,929)
Decrease in trade and other receivables	**9,248**	28,652
Decrease in prepaid expenses and deposits	**4,516**	3,593
Increase/(decrease) in trade and other payables	**1,614**	(24,379)
Increase in deferred revenue	**-**	4,872
Net change in non-cash working capital items	**$ 12,682**	$ 4,809

21. COMMITMENTS FOR EXPENDITURE

As at June 30, 2013, the Company's commitments for expenditure that have not been disclosed elsewhere in the condensed consolidated interim financial statements are as follows:

	As at June 30, 2013			
	Within 1 year	**2-3 years**	**Over 3 years**	**Total**
Capital expenditure commitments	**$ 14,491**	**$ 10,325**	**$ 4,871**	**$ 29,687**
Operating expenditure commitments (i)	**24,940**	**1,782**	**617**	**27,339**
Commitments	**$ 39,431**	**$ 12,107**	**$ 5,488**	**$ 57,026**

(i) Operating expenditure commitments include $17,778 of fees related to the Company's toll wash plant agreement with Ejinaqi Jinda Coal Industry Co. Ltd. This amount reflects the minimum expenditure due under this agreement.

22. CONTINGENCIES

22.1 Governmental, regulatory and internal investigations

The Company is subject to investigations by Mongolia's Independent Authority against Corruption ("the IAAC") and the Mongolian State Investigation Office (the "SIA") regarding allegations against the Company and some of its former employees and one current employee. The IAAC investigation concerns possible breaches of Mongolia's anti-corruption laws, while the SIA investigation concerns possible breaches of Mongolia's money laundering and taxation laws.

While the IAAC investigation into allegations of possible breaches of Mongolian anti-corruption laws has been suspended, the Company has not received notice that the IAAC investigation is complete. To date, three former Company employees and one current Company employee have been named as suspects in the IAAC investigation and are subject to a continuing travel ban imposed by the IAAC. The IAAC has not formally accused any current or former Company employees of breach of Mongolia's anti-corruption laws.

The SIA has not accused any current or former Company employees of money laundering. However, three former Company employees have been informed that they have each been designated as "accused" in connection with the allegations of tax evasion, and are subject to a travel ban. The Company has been designated as a "civil defendant" in connection with the tax evasion allegations, and it may potentially be held financially liable for the criminal misconduct of its former employees, under Mongolian Law. The Company has shown full cooperation with the investigation by providing relevant information. The relevant authorities are yet to conclude on this information. Accordingly, the likelihood or consequences for the Company of a judgment against its former employees is unclear at this time. The SIA also continues to enforce administrative restrictions, which were initially imposed by the IAAC investigation, on certain of the Company's Mongolian assets, including local bank accounts, in connection with its continuing investigation of these allegations.

22. CONTINGENCIES (Continued)

22.1 Governmental, regulatory and internal investigations (Continued)

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 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 produced to the IAAC by the Company has also been produced 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 June 30, 2013 a provision for this matter is not required.

22.2 Mongolian IAAC investigation

During the three months ended June 30, 2013, the IAAC informed the Company that orders, placing restrictions on certain of its Mongolian assets, had been imposed in connection with its continuing investigation.

The orders placing restrictions on certain of the Company's Mongolian assets could ultimately result in an event of default of the Company's CIC convertible debenture. 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.

22. CONTINGENCIES (Continued)

22.2 Mongolian IAAC investigation (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.

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

ADDITIONAL STOCK EXCHANGE INFORMATION

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

A1. TAXATION ON PROFITS

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

For the six months ended June 30, 2013 the Company recorded current income tax expense of $1 (2012: $1,127) related to assessable profit derived from Mongolia at prevailing rates. For the six months ended June 30, 2013, the Company recorded a deferred income tax recovery of $2,087 (2012: $704) related to its Mongolian operations.

A2. SHARE REPURCHASE

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

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

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

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

A3. FINANCIAL INSTRUMENTS

Cash

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

	As at	
	June 30, 2013	**December 31, 2012**
Denominated in U.S. Dollars	**$ 16,572**	$ 18,107
Denominated in Mongolian Tugriks	**1,918**	396
Denominated in Canadian Dollars	**506**	260
Denominated in Hong Kong Dollars	**175**	911
Cash	**$ 19,171**	$ 19,674

Exposure to fluctuations in foreign exchange rates

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

	As at	
	June 30, 2013	**December 31, 2012**
Increase / decrease in foreign exchange rate		
+5%	**$ (101)**	$ 850
–5%	**101**	(850)

A4. COMPLIANCE WITH THE CODE ON CORPORATE GOVERNANCE PRACTICES

The Company has, throughout the six months ended June 30, 2013, applied the principles and complied with the requirements of its corporate governance practices as defined by the Board of Directors and all applicable statutory, regulatory and stock exchange listings standards.

A5. COMPLIANCE WITH MODEL CODE

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

The Board of Directors confirms that all of the Directors of the Company have complied with the required policies in the Company's Corporate Disclosure, Confidentiality and Securities Trading policy throughout the six months ended June 30, 2013.

A6. DIRECTORS' INTERESTS IN SHARES AND SHARE OPTIONS

As at June 30, 2013, the interests of the Company's directors in the shares and share options of the Company and its associated corporations are presented in the following tables.

A6. DIRECTORS' INTERESTS IN SHARES AND SHARE OPTIONS (Continued)

Shares (i)

Name	Name of company	Nature of interest	Shares held	Percentage interest in the company
Kay Priestly	SouthGobi Resources Ltd.	N/A	Nil	Nil
	Turquoise Hill Resources Ltd.	Personal	58,200	0.00%
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	Personal	17,690	0.00%
K. Ross Tromans	SouthGobi Resources Ltd.	N/A	Nil	Nil
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	Personal	8,826	0.00%
	Rio Tinto plc	N/A	Nil	Nil
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
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
André Deepwell	SouthGobi Resources Ltd.	Personal	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
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
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	11,000	0.00%
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%
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	22,289	0.00%

(i) Amounts are presented in total shares held and are not in thousands of shares.

A6. DIRECTORS' INTERESTS IN SHARES AND SHARE OPTIONS (Continued)

Options (i)

Name	Name of company	Number of options held
Kay Priestly	SouthGobi Resources Ltd.	Nil
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	51,917
K. Ross Tromans	SouthGobi Resources Ltd.	Nil
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	25,164
	Rio Tinto plc	Nil
Sean Hinton	SouthGobi Resources Ltd.	112,000
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil
Pierre Lebel	SouthGobi Resources Ltd.	195,000
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil
André Deepwell	SouthGobi Resources Ltd.	190,000
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil
Gordon Lancaster	SouthGobi Resources Ltd.	220,000
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil
Lindsay Dove	SouthGobi Resources Ltd.	50,000
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil
Brett Salt	SouthGobi Resources Ltd.	Nil
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil
Kelly Sanders	SouthGobi Resources Ltd.	Nil
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	57,402

(i) Amounts are presented in total options held and are not in thousands of options.

SouthGobi Resources Ltd.

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

June 30, 2013

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

FORWARD-LOOKING STATEMENTS

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

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

1. OVERVIEW

SouthGobi Resources Ltd. (which, together with its subsidiaries, is collectively referred to as the "Company" or "SouthGobi") is an integrated coal mining, development and exploration company. 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's immediate parent company is Turquoise Hill Resources Ltd. (formerly Ivanhoe Mines Ltd.) ("Turquoise Hill") and at June 30, 2013, Turquoise Hill owned approximately 58% of the outstanding common shares of the Company. Turquoise Hill is controlled by Rio Tinto plc ("Rio Tinto").

The Company owns the following significant coal projects in Mongolia: the Ovoot Tolgoi open pit coal mine (the "Ovoot Tolgoi Mine") and 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 the Ovoot Tolgoi Mine in April 2008 and commenced coal sales in September 2008. Saleable products from the Ovoot Tolgoi Mine will primarily be based on a two product strategy and will consist of SouthGobi standard ("Standard") and SouthGobi premium ("Premium") semi-soft coking coal products. The Standard and Premium semi-soft coking coal products will be produced from raw semi-soft coking coals, together with raw medium and higher-ash coals which can be washed and blended into the Standard and Premium semi-soft coking coal products. Some higher-ash product will be sold as a thermal coal product as required. The Ovoot Tolgoi Mine is covered by a single 9,308 hectare ("ha") mining license and a corresponding permit to mine.

1. OVERVIEW (Continued)

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. The Mineral Resources Authority of Mongolia ("MRAM") has issued the Company a 10,993ha mining license pertaining to the Soumber Deposit. 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 existing mining license and PMA are subject to valid PMA applications (refer to Section 2.1 for additional information). Subsequent to the receipt of the PMAs, the Company intends to proceed through to the mining license application process.

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

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

As at June 30, 2013, SouthGobi owned 18.8% 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.

1. OVERVIEW (Continued)

1.1 Significant Events

Sales volumes and revenue declined to 0.04 million tonnes and $0.4 million, respectively, in the second quarter of 2013 due to the continued softness of the inland China coking coal markets closest to SouthGobi's operations. Economic activity post transition in China's leadership has been slower than expected. The Chinese steel industry has been particularly affected and, as a result, demand and prices for coking coal have been negatively impacted.

In the second quarter of 2013, the Company produced 0.17 million tonnes of raw coal with a strip ratio of 15.55. The Company primarily moved waste material (overburden) and exposed coal in the pit, aligning its operating activities to the significantly lower demand. The Company resumed operations at the Ovoot Tolgoi Mine on March 22, 2013 after having been fully curtailed since the end of the second quarter of 2012.

Subsequent to the end of the second quarter of 2013, SouthGobi entered into a coal supply agreement with Winsway Coking Coal Holdings Limited ("Winsway"), an integrated logistic service provider, for the sale of 1.2 million tonnes of Standard semi-soft coking coal in 2013. This agreement reaffirms the Company's longstanding relationship with Winsway, a key customer, as SouthGobi continues to focus on its 2013 commercial objectives.

On July 16, 2013, SouthGobi announced the appointment of Enkh-Amgalan Sengee as President and Executive Director of SouthGobi Sands LLC, the Company's indirectly wholly-owned subsidiary, effective July 15, 2013.

On July 31, 2013, SouthGobi announced the appointment of Brett Salt as Chief Commercial Officer and his resignation as a non-executive director, effective August 1, 2013.

2. MINERAL PROPERTIES

2.1 Mongolian Coal Division

SouthGobi currently holds three mining licenses and four exploration licenses, which in total cover an area of approximately 325,000ha.

The Company previously held six exploration licenses. However, on June 19, 2013, exploration license 9442X, which was not material to the Company's business, was canceled pursuant to a decision of the Supreme Court of Mongolia (refer to the next section entitled "Regulatory Issues" for additional information). Accordingly, the PMA application in respect of exploration license 9442X is no longer valid. In addition, on August 8, 2013, MRAM notified the Company that it had accepted the Company's application to surrender exploration license 13916X. The Company decided to surrender exploration license 13916X because this license is not considered material or relevant to the Company's present or future operations.

Of the remaining four exploration licenses held by the Company, one exploration license (license 9443X), pertaining to the Soumber Deposit, was issued a PMA on January 18, 2013 by MRAM; while three exploration licenses (licenses 9449X, 13779X and 5267X) have valid PMA applications lodged.

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

Regulatory Issues

Governmental, Regulatory and Internal Investigations

The Company is subject to investigations by Mongolia's Independent Authority against Corruption ("the IAAC") and the Mongolian State Investigation Office (the "SIA") regarding allegations against SouthGobi and some of its former employees and one current employee. The IAAC investigation concerns possible breaches of Mongolia's anti-corruption laws, while the SIA investigation concerns possible breaches of Mongolia's money laundering and taxation laws.

While the IAAC investigation into allegations of possible breaches of Mongolian anti-corruption laws has been suspended, the Company has not received notice that the IAAC investigation is complete. To date, three former SouthGobi employees and one current SouthGobi employee have been named as suspects in the IAAC investigation and are subject to a continuing travel ban imposed by the IAAC. The IAAC has not formally accused any current or former SouthGobi employees of breach of Mongolia's anti-corruption laws.

2. MINERAL PROPERTIES (Continued)

The SIA has not accused any current or former SouthGobi employees of money laundering. However, three former SouthGobi employees have been informed that they have each been designated as "accused" in connection with the allegations of tax evasion, and are subject to a travel ban. The Company has been designated as a "civil defendant" in connection with the tax evasion allegations, and it may potentially be held financially liable for the criminal misconduct of its former employees, under Mongolian Law. The Company has shown full cooperation with the investigation by providing relevant information. The relevant authorities are yet to conclude on this information. Accordingly, the likelihood or consequences for the Company of a judgment against its former employees is unclear at this time.

The SIA also continues to enforce administrative restrictions, which were initially imposed by the IAAC investigation, on certain of the Company's Mongolian assets, including local bank accounts, in connection with its continuing investigation of these allegations. While the orders restrict the use of in-country funds pending the outcome of the investigation, they are not expected to have a material impact on the Company's activities in the short term, although they could create potential difficulties for the Company in the medium to long term. 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.

Certain of the allegations raised by the SIA and IAAC against SouthGobi (concerning 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, conviction, and appeal 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 this case. The Company understands that the court process is now concluded following the decision of the Supreme Court of Mongolia to uphold the convictions.

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

2. MINERAL PROPERTIES (Continued)

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. The fourth exploration license (license 9442X) was canceled on June 19, 2013 by the Supreme Court in the appeal of the above-mentioned case and is no longer held by the Company. Activities historically carried out on this license include drilling, trenching and geological reconnaissance. The Company had no immovable assets located on this license and it did not contain any of SouthGobi's NI 43-101 reserves or resources. This license did 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 Supreme 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 that the Supreme Court has invalidated the transfer of this license, and the license is now held by the Government of Mongolia.

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 produced to the IAAC by the Company has also been produced 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.

2. MINERAL PROPERTIES (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 the Company's Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") for the year ended December 31, 2012, which is available at www.sedar.com, Section 13, 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".

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.

Under the Notice of Investment Dispute, the Company is entitled to commence conciliation/arbitration proceedings under the auspices of the International Centre for Settlement of Investment Disputes pursuant to the Bilateral Investment Treaty. To date, the Company has not commenced conciliation/arbitration proceedings.

2. MINERAL PROPERTIES (Continued)

On January 18, 2013, MRAM issued the Company a PMA pertaining to the Soumber Deposit; however, three 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.

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 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. However, the Government of Mongolia has not provided its approval of the final list. Accordingly, licenses may be added or subtracted to the list at any time prior to approval and publication of the final list.

Portions of the Company's Ovoot Tolgoi and Tsagaan Tolgoi mining licenses and exploration licenses pertaining to the Zag Suuj Deposit and the South Biluut and Jargalant Fields within the Soumber Deposit 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. A part of exploration license 9442X was also potentially affected; however, this license was cancelled on June 19, 2013 by the Supreme Court (refer to section entitled "Regulatory Issues" for additional information).

In regard to the Ovoot Tolgoi mining license, the potential area which may be affected is a relatively small area which represents approximately 3% of the entire area of the mining license and does not contain any of the Company's NI 43-101 reserves or resources or immovable assets. Accordingly, the loss of the potentially affected area would not materially and adversely affect the existing operations.

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

2. MINERAL PROPERTIES (Continued)

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.

Saleable products from the Ovoot Tolgoi Mine will primarily be based on a two product strategy and will consist of Standard and Premium semi-soft coking coal products. The Standard and Premium semi-soft coking coal products will be produced from raw semi-soft coking coals, together with raw medium and higher-ash coals which can be washed and blended into the Standard and Premium semi-soft coking coal products. Some higher-ash product will be sold as a thermal coal product as required.

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.

2. MINERAL PROPERTIES (Continued)

Select Financial and Operational Data

On March 22, 2013, SouthGobi announced the resumption of operations at the Ovoot Tolgoi Mine after having been fully curtailed since the end of the second quarter of 2012. 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 and align production levels with forecast market conditions. The Company is focused on delivering on its commercial strategy and targets. However, as conditions in China's coal markets are expected to remain challenging in the short term, the Company is withdrawing its production guidance of 3.2 million tonnes of semi-soft coking coal for the current year.

	Three months ended June 30,		Six months ended June 30,	
	2013	**2012**	**2013**	**2012**
Volumes, Prices and Costs				
Raw coal production *(millions of tonnes)*	**0.17**	0.27	**0.19**	1.33
Coal sales *(millions of tonnes)*	**0.04**	0.16	**0.12**	1.00
Average realized selling price *(per tonne)*	**$ 14.40**	$ 62.56	**$ 34.62**	$ 57.71
Direct cash costs of product sold excluding idled mine asset costs *(per tonne)* (i)	**$ 10.36**	$ 22.57	**$ 26.94**	$ 12.67
Total cash costs of product sold excluding idled mine asset costs *(per tonne)* (i)	**$ 70.14**	$ 31.49	**$ 50.57**	$ 17.65
Operating Statistics				
Production waste material moved *(millions of bank cubic meters)*	**2.71**	1.16	**3.10**	3.36
Strip ratio *(bank cubic meters of waste material per tonne of coal produced)*	**15.55**	4.31	**16.40**	2.52
Operating Results *($ in thousands)*				
Revenue	**$ 374**	$ 8,412	**$ 3,633**	$ 48,565
Cost of sales				
Mine operations	**6,711**	6,634	**12,159**	24,113
Idled mine asset costs	**5,755**	15,587	**22,168**	15,587
Gross profit/(loss)	**$ (12,092)**	$ (13,809)	**$ (30,694)**	$ 8,865

(i) A non-International Financial Reporting Standards ("IFRS") financial measure, see Section 4

For the three months ended June 30, 2013

For the three months ended June 30, 2013, the Company produced 0.17 million tonnes of raw coal with a strip ratio of 15.55 compared to production of 0.27 million tonnes of raw coal with a strip ratio of 4.31 for the three months ended June 30, 2012. In the second quarter of 2013, the Company primarily moved waste material (overburden) and exposed coal in the pit, aligning its operating activities to the significantly lower demand. The Company's strip ratio of 15.55 for the three months ended June 30, 2013 is not indicative of the Company's strip ratio moving forward.

2. MINERAL PROPERTIES (Continued)

For the three months ended June 30, 2013, SouthGobi recorded revenue of $0.4 million compared to $8.4 million for the three months ended June 30, 2012. Revenue decreased primarily due to decreased sales volumes and a lower average realized selling price. The Company sold 0.04 million tonnes of coal at an average realized selling price of $14.40 per tonne in the second quarter of 2013 compared to sales of 0.16 million tonnes of coal at an average realized selling price of $62.56 per tonne in the second quarter of 2012. SouthGobi's sales volume and average realized selling price was negatively impacted by the continued softness of the inland China coking coal markets closest to SouthGobi's operations. Economic activity post transition in China's leadership has been slower than expected. The Chinese steel industry has been particularly affected and, as a result, demand and prices for coking coal have been negatively impacted. SouthGobi's average realized selling price was also negatively impacted by the Company's sales mix in the second quarter of 2013, which consisted of thermal coal.

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. However, effective October 1, 2012 (for a six month trial period), the royalty was determined using the contracted sales price per tonne, not the reference price per tonne published by the Government of Mongolia. As a result, the Company's effective royalty rate was reduced significantly over the six month trial period. Despite SouthGobi, together with other Mongolian mining companies, engaging the appropriate Government of Mongolia authorities, the six month trial period was not extended and effective April 1, 2013, the royalty on all coal sales exported out of Mongolia was once again based on a set reference price per tonne published monthly by the Government of Mongolia. Based on the reference prices for the second quarter of 2013, the Company was subject to an average 7% royalty based on a weighted average reference price of $70.83 per tonne. The Company's effective royalty rate for the second quarter of 2013, based on the Company's average realized selling price of $14.40 per tonne, was 34%.

Although discussions have not been successful to date, SouthGobi, together with other Mongolian mining companies, continue the dialog with the appropriate Government of Mongolia authorities with the goal of moving to a more equitable process for setting reference prices.

2. MINERAL PROPERTIES (Continued)

Cost of sales was $12.5 million for the three months ended June 30, 2013 compared to $22.2 million for the three months ended June 30, 2012. Cost of sales comprise the direct cash costs of product sold, mine administration cash costs of product sold, idled mine asset costs, inventory impairments, equipment depreciation, depletion of mineral properties and share-based compensation expense. Of the $12.5 million (Q2 2012: $22.2 million) recorded as cost of sales in the second quarter of 2013, $6.7 million (Q2 2012: $6.6 million) related to mine operations and $5.8 million (Q2 2012: $15.6 million) related to idled mine asset costs. In the second quarter of 2013, cost of sales included a coal stockpile impairment of $4.0 million. No coal stockpile impairment was recorded in the second quarter of 2012. Cost of sales from mine operations, exclusive of impairments, decreased in the second quarter of 2013 compared to the second quarter of 2012 due to lower sales volumes partially offset by higher unit costs. Cost of sales related to idled mine asset costs primarily consist of period costs, which are expensed as incurred and primarily include depreciation expense. As a result of the recommencement of mining operations at the Ovoot Tolgoi Mine on March 22, 2013, idled mine asset costs decreased in the second quarter of 2013. However, the 2013 production plan does not fully utilize the Company's existing mining fleet, therefore, idled mine asset costs will continue to be incurred moving forward.

Direct cash costs of product sold excluding idled mine asset costs (a non-IFRS financial measure, see Section 4) were $10.36 per tonne for the three months ended June 30, 2013 compared to $22.57 per tonne for the three months ended June 30, 2012. Direct cash costs of product sold excluding idled mine asset costs primarily decreased in the second quarter of 2013 due to lower cost coal inventory being sold.

Mine administration cash costs of product sold excluding idled mine asset costs (a non-IFRS financial measure, see Section 4) increased to $59.78 per tonne for the three months ended June 30, 2013 from $8.92 per tonne for the three months ended June 30, 2012 primarily due to mine administration costs being allocated over lower sales volumes.

<u>For the six months ended June 30, 2013</u>

For the six months ended June 30, 2013, the Company produced 0.19 million tonnes of raw coal with a strip ratio of 16.40 compared to production of 1.33 million tonnes of raw coal with a strip ratio of 2.52 for the six months ended June 30, 2012. In the first quarter of 2013, the Company's production was significantly impacted by the curtailment of mining operations until March 22, 2013. In the second quarter of 2013, the Company primarily moved waste material (overburden) and exposed coal in the pit, aligning its operating activities to the significantly lower demand. The Company's strip ratio of 16.40 for the six months ended June 30, 2013 is not indicative of the Company's strip ratio moving forward.

2. MINERAL PROPERTIES (Continued)

For the six months ended June 30, 2013, SouthGobi recorded revenue of $3.6 million compared to $48.6 million for the six months ended June 30, 2012. The Company sold 0.12 million tonnes of coal at an average realized selling price of $34.62 per tonne for the six months ended June 30, 2013 compared to sales of 1.00 million tonnes of coal at an average realized selling price of $57.71 per tonne for the six months ended June 30, 2012. Revenue decreased primarily due to decreased sales volumes and a lower average realized selling price.

Revenues are presented net of royalties and selling fees. Based on the reference prices for the six months ended June 30, 2013, the Company was subject to an average 6% royalty based on a weighted average reference price of $53.76 per tonne. The Company's effective royalty rate for the six months ended June 30, 2013, based on the Company's average realized selling price of $34.62 per tonne, was 10%.

Cost of sales was $34.3 million for the six months ended June 30, 2013 compared to $39.7 million for the six months ended June 30, 2012. Cost of sales comprise the direct cash costs of product sold, mine administration cash costs of product sold, idled mine asset costs, inventory impairments, equipment depreciation, depletion of mineral properties and share-based compensation expense. Of the $34.3 million (1H 2012: $39.7 million) recorded as cost of sales for the six months ended June 30, 2013, $12.2 million (1H 2012: $24.1 million) related to mine operations and $22.2 million (1H 2012: $15.6 million) related to idled mine asset costs. Cost of sales related to mine operations decreased for the six months ended June 30, 2013 compared to the six months ended June 30, 2012 primarily due to lower sales volumes, partially offset by higher unit costs and coal stockpile impairments totaling $6.1 million. Cost of sales related to idled mine asset costs primarily consist of period costs, which are expensed as incurred and primarily include depreciation expense. The depreciation expense relates to the Company's idled plant and equipment.

Direct cash costs of product sold excluding idled mine asset costs (a non-IFRS financial measure, see Section 4) were $26.94 per tonne for the six months ended June 30, 2013 compared to $12.67 per tonne for the six months ended June 30, 2012. In the first quarter of 2012, direct cash costs of product sold excluding idled mine asset costs were lower due to a below-trend strip ratio.

Mine administration cash costs of product sold excluding idled mine asset costs (a non-IFRS financial measure, see Section 4) increased to $23.63 per tonne for the six months ended June 30, 2013 from $4.98 per tonne for the six months ended June 30, 2012 primarily due to mine administration costs being allocated over lower sales volumes.

2. MINERAL PROPERTIES (Continued)

Processing Infrastructure

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 50mm and rejects oversize ash. The DCHF 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 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. 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 to toll-wash coals from the Ovoot Tolgoi Mine. The agreement has a duration of five 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 Ejin Jinda's wet washing facility under a separate transportation agreement. Based on preliminary studies, the Company expected coals processed through Ovoot Tolgoi's on-site DCHF to then be washed to produce coals with ash in the range of 8% to 11% at a yield of 85% to 90%. However, the Company is currently reassessing these preliminary studies. The Company continues to expect that washed coals will generally meet semi-soft coking coal specifications. Ejin Jinda will charge the Company a single toll washing fee which will cover their expenses, capital recovery and profit.

2. MINERAL PROPERTIES (Continued)

Construction of Ejin Jinda's wet washing facility is now complete and it has been connected to utility supply. The Company has delayed plans to commence wet washing coals due to the current market conditions. The commencement of wet washing coals will be aligned with improvements in market conditions. As at June 30, 2013, the delay in commencing wet washing coals has had no impact on the carrying value of the Company's prepaid toll washing fees of $33.6 million.

Transportation Infrastructure

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 has the right to conclude a 17 year build, operate and transfer agreement under the Mongolian Law on Concessions. Construction on the paved highway re-commenced in the second quarter of 2013 after a scheduled demobilization in the fourth quarter of 2012 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, 22 Terex MT4400 (218 tonne capacity) haul trucks and two Terex TR100 (91 tonne capacity) haul trucks, together with various pieces of ancillary equipment.

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

2. MINERAL PROPERTIES (Continued)

Workforce

As at June 30, 2013, SouthGobi Sands LLC employed 439 employees in Mongolia. Of the 439 employees, 63 are employed in the Ulaanbaatar office, 3 in outlying offices and 373 at the Ovoot Tolgoi Mine site. Of the total 439 employees based in Mongolia, 430 (98%) are Mongolian nationals and of those, 209 (48%) 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 Deposit resource is located above 300m and is amenable to surface mining.

2. MINERAL PROPERTIES (Continued)

The increase in resource estimate when compared to the previous NI 43-101 compliant independent resource estimate prepared by RPM was identified by RPM when reviewing the technical data for the resources in the course of on-going mine planning studies for the Company. These studies included the reconciliation of RPM Minescape and McElroy Bryan Geological Services Pty Ltd ("MBGS") Minex models. This reconciliation identified aggregation anomalies which resulted in an increase in the resource estimates that were originally reported. Details of the assumptions and parameters used to calculate the resources and coal quality estimates and information on data verification are set out in the Annual Information Form dated March 25, 2013, and available at www.sedar.com.

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

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

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

Environmental baseline studies have been completed and general environmental impact assessments have been approved. The Company has delayed a pre-feasibility study for the Soumber Deposit, pertaining to resources located above 300m, to the first half of 2014; however, the Company will work to continue to further define the Soumber Deposit in the second half of 2013. The Company also continues to delay studying the feasibility of building a coal preparation plant for the Soumber Deposit 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).

2. MINERAL PROPERTIES (Continued)

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

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

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

The increase in resource estimate when compared to the previous NI 43-101 compliant independent resource estimate prepared by RPM was 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.

It is anticipated that coals from the Zag Suuj Deposit can be washed to produce a coking coal product or a coking coal blend product. Limited exploration activities are planned for the Zag Suuj Deposit in 2013. Exploration activities will ensure to meet the requisite requirements under the Mongolian Minerals Law.

2. MINERAL PROPERTIES (Continued)

Ovoot Tolgoi Underground Deposit

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

On March 19, 2012, the Company announced an updated NI 43-101 compliant independent resource estimate prepared by RPM. RPM estimated that the Ovoot Tolgoi Underground Deposit contains measured coal resources of 65.8 million tonnes, indicated coal resources of 43.3 million tonnes and inferred coal resources of 62.0 million tonnes as at October 31, 2011. Details of the assumptions and parameters used to calculate the resources and coal quality estimates and information on data verification are set out in the Annual Information Form dated March 25, 2013, and available at www.sedar.com.

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

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

Tsagaan Tolgoi Deposit

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

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

2. MINERAL PROPERTIES (Continued)

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

Investments

Aspire (18.8% owned)

As at June 30, 2013, SouthGobi owned 18.8% of Aspire, a company listed on the Australian Stock Exchange under the symbol AKM. Aspire's primary focus is its Mongolian coal assets, particularly those pertaining to the Ovoot Coking Coal Project. As at August 12, 2013, SouthGobi had invested a total of $27.9 million in Aspire and its interest in Aspire had a market value of $6.6 million.

On August 28, 2012, Aspire announced that it had received a mining license for the Ovoot Coking Coal Project. 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. Subsequently, on July 31, 2013, Aspire announced an upgraded JORC compliant reserve and resource estimate of 255.0 million tonnes of probable coal reserves, 197.0 million tonnes of measured coal resources, 72.3 million tonnes of indicated coal resources and 11.8 million tonnes of inferred coal resources. Coal resources are inclusive of coal reserves.

Exploration Program

Exploration expenses for the three months ended June 30, 2013 were $0.2 million compared to $2.1 million for the three months ended June 30, 2012. Exploration expenses will vary period to period depending on the number of projects and the related seasonality of the exploration programs. The Company continues to minimize exploration expenditures to preserve the Company's financial resources.

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.

2. MINERAL PROPERTIES (Continued)

2.2 Administrative and Other

For the three months ended June 30, 2013

Refer to section 3 for additional information.

For the six months ended June 30, 2013

Other operating expenses for the six months ended June 30, 2013 were $15.3 million compared to $6.4 million for the six months ended June 30, 2012. For the six months ended June 30, 2013, other operating expenses primarily related to the following:

- Available-for-sale financial asset – the Company recognized an impairment loss of $3.1 million related to its investment in Aspire.
- Materials and supplies inventory – the Company recognized an impairment loss of $6.9 million related to surplus materials and supplies inventories not expected to be utilized with the Company's existing mining fleet.
- Property, plant and equipment – the Company recorded $4.3 million of impairment charges to reduce various items of property, plant and equipment to their recoverable amounts. The impairments relate to surplus capital spares not expected to be utilized with the Company's existing mining fleet.

For the six months ended June 30, 2012, other operating expenses primarily related to a $2.6 million provision for doubtful trade and other receivables and a $2.0 million foreign exchange loss.

Administration expenses for the six months ended June 30, 2013 were $7.8 million compared to $13.4 million for the six months ended June 30, 2012. The decrease in administration expenses primarily relates to decreased corporate administration, salaries and benefits and share-based compensation expenses, partially offset by increased legal and professional fees due to the ongoing governmental, regulatory and internal investigations (refer to section 2.1 for additional details).

Exploration expenses for the six months ended June 30, 2013 were $0.5 million compared to $7.1 million for the six months ended June 30, 2012. Exploration expenses will vary from period to period depending on the number of projects and the related seasonality of the exploration programs. The Company continues to minimize exploration expenditures to preserve the Company's financial resources.

2. MINERAL PROPERTIES (Continued)

Finance costs for the six months ended June 30, 2013 were $10.6 million compared to $4.7 million for the six months ended June 30, 2012. Finance costs for the six months ended June 30, 2013 primarily consisted of $10.0 million of interest expense on the China Investment Corporation ("CIC") convertible debenture; whereas, finance costs for the six months ended June 30, 2012 primarily consisted of a $2.6 million unrealized loss on fair value through profit or loss ("FVTPL") investments and $1.8 million of interest expense on the CIC convertible debenture.

Finance income for the six months ended June 30, 2013 was $4.1 million compared to $26.2 million for the six months ended June 30, 2012. For the six months ended June 30, 2013 and June 30, 2012, finance income primarily consisted of a $4.1 million and $26.0 million unrealized gain on the fair value change of the embedded derivatives in the CIC convertible debenture, respectively. The fair value of the embedded derivatives in the CIC convertible debenture is driven by many factors including: the Company's share price, foreign exchange rates and share price volatility.

For the six months ended June 30, 2013, the Company recorded a $1 thousand current income tax expense related to its Mongolian operations compared to a current income tax expense of $1.1 million for the six months ended June 30, 2012. The Company has recorded a deferred income tax recovery related to deductible temporary differences and loss carry-forwards of $2.1 million for the six months ended June 30, 2013 compared to a deferred income tax recovery related to deductible temporary differences of $0.7 million for the six months ended June 30, 2012.

3. SUMMARY OF QUARTERLY RESULTS

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

	2013		2012				2011	
QUARTER ENDED	**30-Jun**	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec	30-Sep
Revenue	**$ 374**	$ 3,259	$ 1,213	$ 3,337	$ 8,412	$ 40,153	$ 51,064	$ 60,491
Gross profit/(loss) excluding idled mine asset costs	**(6,337)**	(2,187)	(6,894)	(8,601)	1,778	22,674	16,637	17,635
Gross profit margin excluding idled mine asset costs	***-1694%***	*-67%*	*-568%*	*-258%*	*21%*	*56%*	*33%*	*29%*
Gross profit/(loss) including idled mine asset costs	**(12,092)**	(18,601)	(25,336)	(27,532)	(13,809)	22,674	16,637	17,635
Other operating expenses	**(14,877)**	(383)	(18,664)	(29,301)	(3,803)	(2,578)	(24,644)	(138)
Administration expenses	**(4,024)**	(3,733)	(6,079)	(5,178)	(7,497)	(5,882)	(8,612)	(7,993)
Evaluation and exploration expenses	**(221)**	(273)	(508)	(958)	(2,099)	(5,033)	(14,513)	(10,908)
Income/(loss) from operations	**(31,214)**	(22,990)	(50,586)	(62,969)	(27,208)	9,181	(31,132)	(1,404)
Net income/(loss)	**(33,662)**	(24,901)	(51,818)	(54,564)	237	3,126	(18,897)	55,921
Basic income/(loss) per share	**(0.18)**	(0.14)	(0.28)	(0.30)	0.00	0.02	(0.10)	0.31
Diluted income/(loss) per share	**(0.18)**	(0.14)	(0.28)	(0.30)	(0.12)	0.02	(0.14)	(0.02)

	2013		2012				2011	
QUARTER ENDED	**30-Jun**	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec	30-Sep
Raw coal production *(millions of tonnes)*	**0.17**	0.02	-	-	0.27	1.07	1.34	1.25
Sales volumes and prices (i)								
SouthGobi premium semi-soft coking coal								
Coal sales *(millions of tonnes)*	**-**	0.08	0.03	-	0.12	0.31	0.53	0.66
Average realized selling price *(per tonne)*	**$ -**	$ 45.81	$ 47.86	$ -	$ 67.17	$ 67.59	$ 67.62	$ 66.83
SouthGobi standard semi-soft coking coal								
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
SouthGobi thermal coal								
Coal sales *(millions of tonnes)*	**0.04**	0.00	-	0.31	0.00	-	0.25	0.51
Average realized selling price *(per tonne)*	**$ 14.40**	$ 13.67	$ -	$ 15.79	$ 38.80	$ -	$ 40.30	$ 39.74
Total								
Coal sales *(millions of tonnes)*	**0.04**	0.08	0.03	0.31	0.16	0.84	1.15	1.37
Average realized selling price *(per tonne)*	**$ 14.40**	$ 45.02	$ 47.86	$ 15.79	$ 62.56	$ 56.79	$ 55.51	$ 54.01
Costs								
Direct cash costs of product sold excluding idled mine asset costs *(per tonne)* (ii)	**$ 10.36**	$ 35.46	$ 33.11	$ 8.23	$ 22.57	$ 10.80	$ 22.14	$ 22.64
Total cash costs of product sold excluding idled mine asset costs *(per tonne)* (ii)	**$ 70.14**	$ 40.52	$ 38.17	$ 12.12	$ 31.49	$ 15.04	$ 23.09	$ 23.17
Waste movement and stripping ratio								
Production waste material moved *(millions of bank cubic meters)*	**2.71**	0.40	-	-	1.16	2.20	4.58	4.10
Strip ratio *(bank cubic meters of waste material per tonne of coal produced)*	**15.55**	26.21	-	-	4.31	2.07	3.42	3.28
Pre-production waste material moved *(millions of bank cubic meters)*	**-**	-	-	-	-	-	-	0.39
Other operating capacity statistics								
Capacity of key mining fleet								
Number of mining shovels/excavators available at period end	**5**	5	5	4	4	3	3	3
Total combined stated mining shovel/excavator capacity at period end *(cubic meters)*	**113**	113	113	98	98	64	64	64
Number of haul trucks available at period end	**24**	31	27	27	27	27	25	16
Total combined stated haul truck capacity at period end *(tonnes)*	**4,978**	5,615	4,743	4,743	4,743	4,743	4,561	2,599
Employees and safety								
Employees at period end	**449**	444	465	644	693	720	720	695
Lost time injury frequency rate (iii)	**-**	-	0.1	0.2	0.2	0.3	0.2	0.2

(i) The sales volumes and prices that have been previously disclosed as raw semi-soft coking coal, raw medium-ash coal and raw higher-ash coal have now been reclassified as SouthGobi premium semi-soft coking coal, SouthGobi standard semi-soft coking coal and SouthGobi thermal coal, respectively, to reflect the Company's new product strategy

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

(iii) Per 200,000 man hours

3. SUMMARY OF QUARTERLY RESULTS (Continued)

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

On March 22, 2013, SouthGobi announced the resumption of operations at its flagship Ovoot Tolgoi Mine. The Company recognized revenue of $0.4 million in the second quarter of 2013 compared to $3.3 million in the first quarter of 2013 and $8.4 million in the second quarter of 2012. In the first half of 2013, the Company's sales volume and average realized selling price continued to be negatively impacted by the softness of the inland China coking coal markets closest to SouthGobi's operations. Subsequent to the end of the second quarter of 2013, SouthGobi entered into a coal supply agreement with Winsway, an integrated logistic service provider, for the sale of 1.2 million tonnes of Standard semi-soft coking coal in 2013.

SouthGobi's effective royalty rate in the second quarter of 2013 was 34%, significantly higher than the 6% effective royalty rate in the first quarter of 2013. Effective October 1, 2012 (for a six month trial period) the royalty was determined using the contracted sales price per tonne, not the reference price per tonne published by the Government of Mongolia. Despite SouthGobi, together with other Mongolian mining companies, engaging the appropriate Government of Mongolia authorities, the six month trial period was not extended and effective April 1, 2013, the royalty on all coal sales exported out of Mongolia was once again based on a set reference price per tonne published monthly by the Government of Mongolia. Although discussions have not been successful to date, SouthGobi, together with other Mongolian mining companies, continue the dialog with the appropriate Government of Mongolia authorities with the goal of moving to a more equitable process for setting reference prices.

Cost of sales was $12.5 million in the second quarter of 2013 compared to $21.9 million in the first quarter of 2013 and $22.2 million in the second quarter of 2012. Cost of sales comprise the direct cash costs of product sold, mine administration cash costs of product sold, idled mine asset costs, inventory impairments, equipment depreciation, depletion of mineral properties and share-based compensation expense. Of the $12.5 million, $21.9 million and $22.2 million recorded as cost of sales in the second quarter of 2013, the first quarter of 2013 and the second quarter of 2012, $6.7 million, $5.4 million and $6.6 million related to mine operations and $5.8 million, $16.4 million and $15.6 million related to idled mine asset costs, respectively. Cost of sales from mine operations in the second quarter of 2013 and the first quarter of 2013 included coal stockpile impairments of $4.0 million and $2.2 million, respectively, to reduce the carrying value of the coal stockpiles to their estimated net realizable values. Cost of sales from mine operations, exclusive of impairments, decreased in the second quarter of 2013 compared to the second quarter of 2012 due to lower sales volumes, partially offset by higher unit costs.

3. SUMMARY OF QUARTERLY RESULTS (Continued)

Cost of sales from idled mine asset costs decreased in the second quarter of 2013 due to the recommencement of mining operations at the Ovoot Tolgoi Mine on March 22, 2013. However, the 2013 production plan does not fully utilize the Company's existing mining fleet, therefore, idled mine asset costs will continue to be incurred moving forward.

The Company recorded a gross loss of $12.1 million in the second quarter of 2013, $18.6 million in the first quarter of 2013 and $13.8 million in the second quarter of 2012. SouthGobi's gross loss in these periods was negatively impacted by idled mine asset costs. The Company recorded a gross loss excluding idled mine asset costs of $6.3 million in the second quarter of 2013 and $2.2 million in the first quarter of 2013 compared to a gross profit excluding idled mine asset costs of $1.8 million in the second quarter of 2012. Gross profit will vary by quarter depending on sales volumes, sales prices and unit costs.

Other operating expenses in the second quarter of 2013 were $14.9 million compared to $0.4 million in the first quarter of 2013 and $3.8 million in the second quarter of 2012. In the second quarter of 2013, other operating expenses primarily related to the following:

- Available-for-sale financial asset – the Company recognized an impairment loss of $3.1 million related to its investment in Aspire.
- Materials and supplies inventory – the Company recognized an impairment loss of $6.9 million related to surplus materials and supplies inventories not expected to be utilized with the Company's existing mining fleet.
- Property, plant and equipment – the Company recorded $4.3 million of impairment charges to reduce various items of property, plant and equipment to their recoverable amounts. The impairments relate to surplus capital spares not expected to be utilized with the Company's existing mining fleet.

In the first quarter of 2013, other operating expenses primarily related to $0.3 million of foreign exchange losses. In the second quarter of 2012, other operating expenses primarily related to a $2.6 million provision for doubtful trade and other receivables.

Administration expenses in the second quarter of 2013 were $4.0 million compared to $3.7 million in the first quarter of 2013 and $7.5 million in the second quarter of 2012. The increase in administration expenses in the second quarter of 2013 compared to the first quarter of 2013 primarily related to increased legal expenses due to the ongoing governmental, regulatory and internal investigations (refer to section 2.1 for additional details). The decrease in administration expenses in the second quarter of 2013 compared to the second quarter of 2012 primarily related to decreased corporate administration, salaries and benefits and share-based compensation expenses, partially offset by increased legal and professional fees due to the ongoing governmental, regulatory and internal investigations.

3. SUMMARY OF QUARTERLY RESULTS (Continued)

Exploration expenses in the second quarter of 2013 were $0.2 million compared to $0.3 million in the first quarter of 2013 and $2.1 million in the second quarter of 2012. Exploration expenses will vary from quarter to quarter depending on the number of projects and the related seasonality of the exploration programs. The Company continues to minimize exploration expenditures to preserve the Company's financial resources.

Finance costs in the second quarter of 2013 were $5.6 million compared to $4.0 million in the second quarter of 2012. Finance costs in the second quarter of 2013 primarily consisted of $5.1 million of interest expense on the CIC convertible debenture; whereas, finance costs in the second quarter of 2012 primarily consisted of a $2.3 million unrealized loss on FVTPL investments and $1.6 million of interest expense on the CIC convertible debenture.

Finance income in the second quarter of 2013 was $3.4 million compared to $26.9 million in the second quarter of 2012. In the second quarter of 2013 and 2012, finance income primarily consisted of a $3.3 million and $26.8 million unrealized gain on the fair value change of the embedded derivatives in the CIC convertible debenture, respectively. The fair value of the embedded derivatives in the CIC convertible debenture is driven by many factors including: the Company's share price, foreign exchange rates and share price volatility.

In the second quarter of 2013, the Company recorded $nil current income tax expense related to its Mongolian operations compared to a current income tax recovery of $3.7 million in the second quarter of 2012. The Company has recorded a deferred income tax expense related to deductible temporary differences and loss carry-forwards of $0.2 million in the second quarter of 2013 compared to a deferred income tax recovery related to deductible temporary differences of $0.6 million in the second quarter of 2012.

As a result of the above factors, the Company recorded a net loss of $33.7 million in the second quarter of 2013 compared to a net loss of $24.9 million in the first quarter of 2013 and a net income of $0.2 million in the second quarter of 2012.

(Expressed in U.S. Dollars)

3. SUMMARY OF QUARTERLY RESULTS (Continued)

Adjusted net loss (a non-IFRS financial measure, see Section 4) was $13.9 million in the second quarter of 2013 compared to an adjusted net loss of $11.6 million in the first quarter of 2013 and an adjusted net loss of $6.8 million in the second quarter of 2012. Adjusted net loss increased in the second quarter of 2013 compared to the first quarter of 2013 primarily due to higher deferred income tax expenses. Adjusted net loss increased in the second quarter of 2013 compared to the second quarter of 2012 primarily due to decreased gross profits, excluding idled mine asset costs, an increased proportion of interest expense on the CIC convertible debenture being expensed as opposed to capitalized, lower current income tax recoveries and higher deferred income tax expenses.

	2013		2012				2011	
QUARTER ENDED	**30-Jun**	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec	30-Sep
Net income/(loss)	**$ (33,662)**	$ (24,901)	$ (51,818)	$ (54,564)	$ 237	$ 3,126	$ (18,897)	$ 55,921
Income/(loss) adjustments, net of tax								
Idled mine asset costs	**4,316**	12,312	14,474	13,572	10,966	-	-	-
Share-based compensation expense/(recovery)	**(21)**	154	(1,144)	1,490	4,383	3,799	4,050	4,296
Net impairment loss/(recovery) on assets	**18,269**	1,621	22,814	34,299	2,583	-	23,818	(2,925)
Unrealized foreign exchange losses/(gains)	**12**	(38)	750	179	(511)	(950)	34	103
Unrealized loss/(gain) on embedded derivatives in CIC debenture	**(3,343)**	(748)	(662)	(12,856)	(26,770)	776	(10,790)	(62,058)
Realized loss/(gain) on disposal of FVTPL investments	**43**	-	15	-	46	(85)	-	-
Unrealized loss/(gain) on FVTPL investments	**473**	(5)	664	1,197	2,282	339	155	2,449
Adjusted net income/(loss) (i)	**(13,913)**	(11,605)	(14,907)	(16,683)	(6,784)	7,005	(1,630)	(2,214)

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

4. NON-IFRS FINANCIAL MEASURES

($ in thousands, unless otherwise stated)

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

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

Cash costs

The Company uses cash costs to describe its cash production costs. Cash costs incorporate all production costs, which include direct and indirect costs of production, with the exception of idled mine asset costs and non-cash expenses which are excluded. Non-cash expenses include share-based compensation expense, 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.

4. NON-IFRS FINANCIAL MEASURES (Continued)

	Three months ended June 30,		Six months ended June 30,	
	2013	**2012**	**2013**	**2012**
Cash costs				
Cost of sales per financial statements	**$ 12,466**	$ 22,221	**$ 34,327**	$ 39,700
Less non-cash expenses	**(3,934)**	(1,659)	**(6,260)**	(6,546)
Less non-cash idled mine asset costs	**(5,716)**	(9,750)	**(16,872)**	(9,750)
Total cash costs	**2,816**	10,812	**11,195**	23,404
Less idled mine asset cash costs	**(39)**	(5,837)	**(5,296)**	(5,837)
Total cash costs excluding idled mine asset costs	**2,777**	4,975	**5,899**	17,567
Coal sales *(000's of tonnes)*	**40**	158	**117**	995
Total cash costs of product sold excluding idled mine asset costs *(per tonne)*	**$ 70.14**	$ 31.49	**$ 50.57**	$ 17.65

	Three months ended June 30,		Six months ended June 30,	
	2013	**2012**	**2013**	**2012**
Cash costs				
Direct cash costs of product sold excluding idled mine asset costs *(per tonne)*	**$ 10.36**	$ 22.57	**$ 26.94**	$ 12.67
Mine administration cash costs of product sold excluding idled mine asset costs *(per tonne)*	**59.78**	8.92	**23.63**	4.98
Total cash costs of product sold excluding idled mine asset costs *(per tonne)*	**$ 70.14**	$ 31.49	**$ 50.57**	$ 17.65

Adjusted net income/(loss)

Adjusted net income/(loss) excludes idled mine asset costs, share-based compensation expense/(recovery), net impairment loss/(recovery) on assets, unrealized foreign exchange losses/(gains), unrealized loss/(gain) on the fair value change of the embedded derivatives in the CIC convertible debenture, realized 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.

5. 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, including interest payments due on the CIC convertible debenture, for at least twelve months from the end of the June 30, 2013 reporting period. The Company expects its liquidity to remain sufficient based on existing capital resources and estimated income from mining operations. Estimated income from mining operations is subject to a number of external market factors including supply and demand and pricing in the coal industry. The Company continues to minimize uncommitted capital expenditures and exploration expenditures in order to preserve the Company's financial resources.

The Company has in place a planning, budgeting and forecasting process to help determine the funds required to support the Company's normal operations on an ongoing basis and its expansionary plans. Factors that could impact the Company's liquidity are monitored regularly and include, but are not limited to, Chinese economic growth, market prices of coal, production levels, operating cash costs, capital costs, exchange rates of currencies of countries where the Company operates and exploration and discretionary expenditures.

Factors currently creating uncertainty for the Company's operations include the continued softness of inland China coking coal markets, ongoing governmental, regulatory and internal investigations (refer to section 2.1 "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 2.1 "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 was required primarily to support the accelerated investment program in Mongolia and up to $120 million of the financing could also be used for working capital, repayment of debt due on funding, general and administrative expenses and other general corporate purposes. The Company's actual use of financing has been in accordance with the above.

On March 29, 2010, the Company exercised its right to call for the conversion of up to $250.0 million of the CIC convertible debenture into 21.5 million shares at a conversion price of $11.64 (Cdn$11.88). As at June 30, 2013, the CIC owned through its indirect wholly owned subsidiary approximately 14% of the Company.

5. LIQUIDITY AND CAPITAL RESOURCES (Continued)

During the three months ended June 30, 2013, the Company and the CIC mutually agreed upon a three month deferral of the convertible debenture semi-annual $7.9 million cash interest payment due on May 19, 2013. The $7.9 million cash interest payment is now due on August 19, 2013. The mutually agreed upon deferral of the cash interest payment did not trigger an event of default and all other terms of the convertible debenture remain unchanged.

The terms of the CIC convertible debenture provide for the 1.6% share interest payment of $4.0 million to be paid annually in common shares of the Company. On May 17, 2012, the Parliament of Mongolia approved a Law on Regulation of Foreign Investment in Business Entities Operating in Sectors of Strategic Importance ("Foreign Investment Law") that regulates foreign direct investment into a number of key sectors of strategic importance, which includes mineral resources. Prior to the amendments in the second quarter of 2013, if foreign shareholding exceeded 49% of an asset and the amount of the investment at the time exceeds 100 billion Mongolian Tugriks (approximately $69.0 million), then parliamentary approval was required. In the case of state owned entities there was no minimum threshold and all proposed investments from state owned entities required parliamentary approval. In addition, if a foreign entity wanted to acquire one third or more of the shares in an investment in a strategic sector, then the 100 billion Mongolian Tugrik threshold was not applicable and cabinet approval for the investment was required regardless of the value.

As a result of the Foreign Investment Law, the Company expected that it would require parliamentary approval for the shares to be issued for the November 19, 2012 share interest payment to the CIC. As a result, in the first quarter of 2013, the Company settled the 1.6% share interest payment of $4.0 million in cash.

Following amendments to the Foreign Investment Law, passed in the second quarter of 2013, the requirement for parliamentary approval has been limited to circumstances where a state owned entity is to exceed 49% share ownership of a strategic asset, irrespective of the amount of investment. As a result, the Company understands that it will now only require cabinet approval, rather than parliamentary approval, under the Foreign Investment Law for the 1.6% share interest payment to the CIC. The Company will fully comply with the requirements of the Foreign Investment Law in connection with share interest payments.

In the first quarter of 2013, the Company was subject to orders imposed by the IAAC which placed restrictions on certain of the Company's Mongolian assets. The orders were imposed on the Company in connection with the IAAC's investigation of the Company. The SIA also continues to enforce the orders on the Company.

5. LIQUIDITY AND CAPITAL RESOURCES (Continued)

The orders placing restrictions on certain of the Company's Mongolian assets could ultimately result in an event of default of the Company's CIC convertible debenture. 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.

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 June 30, 2013, the Company had cash of $19.2 million compared to cash of $19.7 million and short term money market investments of $15.0 million for a total of $34.7 million in cash and money market investments as at December 31, 2012. Working capital (excess current assets over current liabilities) was $78.0 million as at June 30, 2013 compared to $127.2 million as at December 31, 2012.

As at June 30, 2013, the Company's gearing ratio was 0.15 (December 31, 2012: 0.14), which was calculated based on the Company's long term liabilities to total assets. As at June 30, 2013, the Company is not subject to any externally imposed capital requirements.

Trade and other receivables decreased to $7.9 million as at June 30, 2013 compared to $17.4 million as at December 31, 2012. 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.

5. LIQUIDITY AND CAPITAL RESOURCES (Continued)

Cash Flow Highlights

($ in thousands)

	Six months ended June 30, 2013	Six months ended June 30, 2012
Cash generated from/(used in) operating activities	**$ (7,193)**	$ 1,172
Cash generated from/(used in) investing activities	**6,459**	(62,805)
Cash generated from/(used in) financing activities	**81**	(508)
Effect of foreign exchange rate changes on cash	**150**	152
Decrease in cash for the period	**(503)**	(61,989)
Cash balance, beginning of the period	**19,674**	123,567
Cash balance, end of the period	**$ 19,171**	$ 61,578

Cash generated from/(used in) operating activities

Cash used in operating activities for the six months ended June 30, 2013 was $7.2 million compared to cash generated from operating activities for the six months ended June 30, 2012 of $1.2 million. The cash outflow for the six months ended June 30, 2013 primarily relates to reduced cash flows from operations, as a result of significantly reduced revenues stemming from the continued softness of the inland China coking coal markets closest to SouthGobi's operations, partially offset by changes in working capital.

Cash generated from/(used in) investing activities

Cash generated from investing activities was $6.5 million for the six months ended June 30, 2013 compared to cash used in investing activities of $62.8 million for the six months ended June 30, 2012. In the first half of 2013, cash generated from investing activities primarily related to the proceeds from maturing investments partially offset by deferred stripping activities; whereas in the first half of 2012, cash used in investing activities primarily related to expenditures on property, plant and equipment, partially offset by proceeds from maturing investments.

Cash generated from/(used in) financing activities

For the six months ended June 30, 2013, the Company generated cash from financing activities of $0.1 million from the issuance of common shares. For the six months ended June 30, 2012, cash used in financing activities was $0.5 million, primarily due to net repayments on the line of credit facility and the repurchase of $1.0 million of the Company's common shares, partially offset by the issuance of common shares and exercise of stock options.

5. LIQUIDITY AND CAPITAL RESOURCES (Continued)

In the first quarter of 2013, the Company's revolving line of credit facility with Golomt Bank in Mongolia expired. The line of credit facility was used by the Company's Mongolian Coal Division as part of its working capital management. The revolving line of credit has not been renewed.

Contractual Obligations and Guarantees

Day-to-day mining, expansionary and sustaining capital expenditures as well as administrative operations give rise to commitments for future minimum payments. 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, including interest payments due on the CIC convertible debenture, for at least twelve months from the end of the June 30, 2013 reporting period. The Company expects its liquidity to remain sufficient based on existing capital resources and estimated income from mining operations. Estimated income from mining operations is subject to a number of external market factors including supply and demand and pricing in the coal industry. As at June 30, 2013, the Company's operating and capital commitments were:

($ in thousands)	As at June 30, 2013			
	Within 1 year	**2-3 years**	**Over 3 years**	**Total**
Capital expenditure commitments	$ 14,491	$ 10,325	$ 4,871	$ 29,687
Operating expenditure commitments [(i)]	24,940	1,782	617	$ 27,339
Commitments	$ 39,431	$ 12,107	$ 5,488	$ 57,026

(i) Operating expenditure commitments include $17.8 million of fees related to the Company's toll wash plant agreement with Ejinaqi Jinda. This amount reflects the minimum expenditure due under this agreement.

Impairment analysis

During the three months ended June 30, 2013, the Company determined that an indicator of impairment existed for its property, plant and equipment related to the Ovoot Tolgoi Mine. The impairment indicator was the continued weakness in the Company's share price.

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 June 30, 2013. The Company's property, plant and equipment, including mineral properties, totaled $508.7 million as at June 30, 2013.

5. LIQUIDITY AND CAPITAL RESOURCES (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 June 30, 2013. The Company believes that the estimates and assumptions incorporated in the impairment analysis are reasonable; however, the estimates and assumptions are subject to significant uncertainties and judgments.

Financial instruments

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

The fair values of financial instruments that are traded on an active liquid market are determined with reference to the quoted market prices. The fair value of the Company's investment in the shares of Kangaroo Resources Limited ("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.

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

5. LIQUIDITY AND CAPITAL RESOURCES (Continued)

		As at		
Financial assets *($ in thousands)*		**June 30, 2013**		**December 31, 2012**
Loans-and-receivables				
Cash	**$**	**19,171**	$	19,674
Trade and other receivables		**7,947**		17,430
Available-for-sale				
Investment in Aspire		**5,661**		8,727
Fair value through profit or loss				
Investment in Kangaroo		**718**		1,455
Money market investments		**-**		15,000
Total financial assets	**$**	**33,497**	$	62,286
Financial liabilities *($ in thousands)*				
Fair value through profit or loss				
Convertible debenture - embedded derivatives	**$**	**4,786**	$	8,876
Other-financial-liabilities				
Trade and other payables		**16,184**		10,216
Convertible debenture - debt host		**103,123**		97,092
Total financial liabilities	**$**	**124,093**	$	116,184

Net income/(loss) for the three and six months ended June 30, 2013 and June 30, 2012 included the following amounts of unrealized losses/(gains) from the fair value adjustments to certain financial instruments which are classified as FVTPL:

	Three months ended June 30,		Six months ended June 30,	
($ in thousands)	**2013**	**2012**	**2013**	**2012**
Unrealized loss on FVTPL investments	**$ 473**	$ 2,282	**$ 468**	$ 2,620
Unrealized (gain) on embedded derivatives in CIC debenture	**(3,343)**	(26,770)	**(4,091)**	(25,995)

Other comprehensive income for the three months ended June 30, 2013 consists of an unrealized loss net of tax on the Company's investment in Aspire. For the three and six months ended June 30, 2013, the Company recognized an impairment loss of $3.1 million in other operating expenses related to its investment in Aspire.

Other comprehensive income for the three and six months ended June 30, 2012 consists of unrealized losses, net of tax, of $20.1 million and $25.5 million, respectively.

6. ENVIRONMENT

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

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

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

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

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

The Board maintains a Health, Environment, Safety and Social Responsibility Committee. The Committee is composed of 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.

7. RELATED PARTY TRANSACTIONS

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

- Turquoise Hill – Turquoise Hill is the Company's immediate parent company and at June 30, 2013 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 June 30, 2013 Rio Tinto controlled Turquoise Hill. The Company recovers administration and other costs incurred on behalf of Rio Tinto on a cost-recovery basis. Rio Tinto recovers from the Company the costs of salaries and benefits of employees assigned to work for the Company.
- Global Mining Management ("GMM") – GMM is a private company owned equally by seven companies, two of which include the Company and Turquoise Hill. GMM provides administration, accounting and other office services to the Company on a cost-recovery basis.
- 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 in 2012 had two directors in common with the Company. The Company provided some office and investor relations services to Ivanhoe Energy in the Company's Hong Kong office and recovered the costs for those services on a cost-recovery basis. The Company's provision of office and investor relations services to Ivanhoe Energy ceased on June 30, 2012.

7. RELATED PARTY TRANSACTIONS (Continued)

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

($ in thousands)	Three months ended June 30,		Six months ended June 30,	
	2013	**2012**	**2013**	**2012**
Corporate administration	**$ 227**	$ 479	**$ 380**	$ 847
Salaries and benefits	**296**	245	**483**	571
Total related party expenses	**$ 523**	$ 724	**$ 863**	$ 1,418

($ in thousands)	Three months ended June 30,		Six months ended June 30,	
	2013	**2012**	**2013**	**2012**
GMM	**$ 5**	$ 286	**$ 57**	$ 717
Turquoise Hill	**62**	23	**99**	27
Rio Tinto	**276**	-	**390**	-
I2MS	**180**	415	**317**	674
Total related party expenses	**$ 523**	$ 724	**$ 863**	$ 1,418

The Company recorded recoveries of $nil and $7.0 thousand for the three and six months ended June 30, 2013 for administration expenses with Rio Tinto compared to recoveries of $0.2 million and $0.5 million for the three and six months ended June 30, 2012 for administration expenses with Turquoise Hill and Ivanhoe Energy.

The Company had accounts receivable of $0.2 million as at June 30, 2013 (December 31, 2012: $0.7 million) and accounts payable of $0.5 million as at June 30, 2013 (December 31, 2012: $35.0 thousand) with related parties.

Emolument Policy

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

7. RELATED PARTY TRANSACTIONS (Continued)

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

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

As at June 30, 2013, the Company employed 449 employees.

8. OUTSTANDING SHARE DATA

The Company is authorized to issue an unlimited number of common shares without par value and an unlimited number of preferred shares without par value. As at August 12, 2013, 182.0 million common shares were issued and outstanding. There are also incentive share options outstanding to acquire 2.9 million unissued common shares with exercise prices ranging from Cdn$1.92 to Cdn$18.86. There are no preferred shares outstanding.

As at August 12, 2013, Turquoise Hill directly owned 104.8 million common shares representing approximately 58% of the issued and outstanding common shares of the Company.

9. INTERNAL CONTROLS OVER FINANCIAL REPORTING

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

10. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

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

Please refer to Note 3.23 of the Company's December 31, 2012 Consolidated Annual Financial Statements for information regarding the accounting judgments and estimates that have the most significant effect on the amounts recognized in the Company's Consolidated Annual Financial Statements. These significant accounting judgments and estimates remain unchanged from December 31, 2012.

11. ACCOUNTING PRONOUNCEMENTS

The Company has adopted the new and revised standards and interpretations issued by the International Accounting Standards Board (the "IASB") listed below effective January 1, 2013. These changes were made in accordance with the transitional provisions outlined in the respective standards and interpretations.

<u>IFRS 10 Consolidated Financial Statements</u>

IFRS 10 replaces International Accounting Standard ("IAS") 27 "Consolidated and Separate Financial Statements" and SIC 12 "Consolidation – Special Purpose Entities". IFRS 10 establishes principles for the presentation and preparation of consolidated financial statements when an entity controls multiple entities. The new consolidation standard changes the definition of control so that the same criteria apply to all entities, both operating and special purpose entities, to determine control. The revised definition focuses on the need to have both power over the investee and exposure to variable returns before control is present. The adoption of IFRS 10 did not result in any change in the consolidation status of any of the Company's subsidiaries and investees.

11. ACCOUNTING PRONOUNCEMENTS (Continued)

IFRS 11 Joint Arrangements

IFRS 11 replaces IAS 31 "Interests in Joint Ventures". IFRS 11 classifies joint arrangements as either joint operations or joint ventures, depending on the rights and obligations of the parties involved in the joint arrangement. Joint arrangements that are classified as joint operations require the venturers to recognize the individual assets, liabilities, revenues and expenses to which they have legal rights or are responsible. Joint arrangements that are classified as a joint venture are accounted for using the equity method of accounting.

As a result of the adoption of IFRS 11, the Company's 40% interest in RDCC is now classified as a joint venture (previously classified as a jointly-controlled entity under IAS 31). Prior to the adoption of IFRS 11, the Company accounted for its investment in RDCC under the equity method of accounting. Therefore, the adoption of IFRS 11 did not have an impact on the Consolidated Financial Statements for the current or prior periods presented.

IFRS 12 Disclosure of Interests in Other Entities

IFRS 12 outlines the disclosure requirements for interests in subsidiaries and other entities. The adoption of IFRS 12 will result in incremental disclosures in the Company's Consolidated Annual Financial Statements.

IFRS 13 Fair Value Measurement

IFRS 13 provides a definition of fair value, sets out a single IFRS framework for measuring fair value and outlines disclosure requirements for fair value measurements. The adoption of IFRS 13 has resulted in additional fair value measurement disclosures in the Company's Condensed Consolidated Interim Financial Statements (refer to Note 18) and will result in incremental disclosures in the Company's Annual Consolidated Financial Statements.

IAS 1 Presentation of Financial Statements (Amendment)

The amendments to IAS 1 requires companies preparing financial statements under IFRS to group items within other comprehensive income that may be reclassified to profit or loss and those that will not be reclassified. The consolidated statement of comprehensive income in the Company's Condensed Consolidated Interim Financial Statements has been amended to reflect the presentation requirements under the amended IAS 1.

11. ACCOUNTING PRONOUNCEMENTS (Continued)

IFRIC 20 Stripping Costs in the Production Phase of a Surface Mine

IFRIC 20 provides guidance on the accounting for the costs of stripping activities during the production phase of a surface mine. Under IFRIC 20, stripping activity assets are recognized when the following three criteria are met:

- it is probable that the future economic benefit (improved access to the ore body) associated with the stripping activity will flow to the entity;
- the entity can identify the component of the ore body for which access has been improved; and
- the costs relating to the stripping activity associated with that component can be measured reliably

If not all of the criteria are met, the stripping activity costs are included in the costs of inventory produced during the period incurred.

The Company assessed its open-pit mining operations at the Ovoot Tolgoi Mine and concluded that as at January 1, 2012 there are identifiable coal seams with which the predecessor stripping activity related to. Therefore, no adjustment to the Company's Consolidated Financial Statements was required upon initial transition to IFRIC 20.

The adoption of IFRIC 20 has not resulted in a change in the Company's capitalization of stripping activity costs, and therefore no adjustment was required to the Company's Consolidated Financial Statements in the current or prior periods presented. The Company classifies stripping activity assets capitalized under IFRIC 20 as mineral property costs within property, plant and equipment and these costs are amortized on a units-of-production basis based on proven and probable reserves.

Other

The IASB also amended IAS 19 "Post-Employment Benefits" and IAS 28 "Investments in Associates" (2003) effective January 1, 2013. The amendments to these standards did not impact the Company's Consolidated Financial Statements.

IFRS 9 "Financial Instruments" is effective for years beginning on or after January 1, 2015. The IASB issued IFRS 9 as the first step in its project to replace IAS 39 "Financial Instruments: Recognition and Measurement". The Company will assess the impact of this new standard closer to its implementation date.

12. RISK FACTORS

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

Material risks and uncertainties affecting the Company, their potential impact and the Company's principal risk management strategies are substantially unchanged from those disclosed in the Company's MD&A for the year ended December 31, 2012, which is available at www.sedar.com.

13. OUTLOOK

Economic activity post transition in China's leadership has been slower than expected. The Chinese steel industry has been particularly affected and, as a result, demand and prices for coking coal have been negatively impacted. Certain coal price indices in China have reached four year lows and coal consumption and production in regions close to the Mongolian border have dropped significantly year on year. There has been a 36%[1] drop year on year to June 30, 2013 in Mongolian coal exports to China. Current sentiment indicates that market conditions will remain challenging for the remainder of the year. The longer term outlook is more positive; however, the timing of any recovery in 2014 remains uncertain and dependent on the Chinese economy.

The Company resumed operations at the Ovoot Tolgoi Mine on March 22, 2013 after having been fully curtailed since the end of the second quarter of 2012. The recommencement of operations has taken place without incident. In the second quarter of 2013, the Company primarily moved waste material (overburden) and exposed coal in the pit, aligning its operating activities to the significantly lower demand. Subsequent to the end of the second quarter of 2013, SouthGobi entered into a coal supply agreement with Winsway, an integrated logistic service provider, for the sale of 1.2 million tonnes of Standard semi-soft coking coal product in 2013. Pricing for the coal to be sold under this contract will be based upon a floating monthly index. This agreement reaffirms the Company's longstanding relationship with Winsway, a key customer, as SouthGobi continues to focus on its 2013 commercial objectives. In addition, two small spot market sales were concluded subsequent to the end of the second quarter of 2013 and discussions with other potential customers are ongoing.

[1] China Coal Resource (en.sxcoal.com)

13. OUTLOOK (Continued)

The rate of production in the second half of 2013 is expected to increase as the Company makes further sales and provides contractual tonnages under the Winsway coal supply agreement. The Company is focused on delivering on its commercial strategy and targets. However, as market conditions in China's coking coal markets are expected to remain challenging in the short term, the Company is withdrawing its production guidance of 3.2 million tonnes of semi-soft coking coal for the current year.

Whilst SouthGobi has a predominantly two product strategy of a Premium and Standard semi-soft coking coal product from the Ovoot Tolgoi Mine, the capability to begin supplying a washed semi-soft coking coal product is an important step in improving both SouthGobi's market position and access to end customers. The Company has had to modify its plans and delay production of the washed product. The timing for washing will be aligned with improvements in market conditions for this type of product. SouthGobi is however planning to mine some Premium semi-soft coking coal product as a raw coal in 2013.

The Company has been minimizing uncommitted capital expenditures, exploration and operational expenditures in order to preserve its financial resources. For at least twelve months from the end of the June 30, 2013 reporting period, the Company expects its liquidity to remain sufficient based on existing capital resources and estimated income from mining operations. Estimated income from mining operations is subject to a number of external market factors including supply and demand and pricing in the coal industry.

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.

13. OUTLOOK (Continued)

- 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

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. 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 the Ovoot Tolgoi Mine 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 of the Soumber Deposit in order to commence small-scale mining activities in 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. The timing for washing will be aligned with improvements in market conditions for this type of product.
- 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.

August 12, 2013