SouthGobi Resources

Annual Report 2014

TSX: SGQ HKEX :1878

SouthGobi Resources Ltd.
Annual Report 2014

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SouthGobi Resources Ltd. (the "Company" or "SouthGobi") is focused on the exploration, development and production of its coking coal deposits in Mongolia's South Gobi Region. The Company has a 100% shareholding in SouthGobi Sands LLC, the Mongolian registered company that holds SouthGobi's mining and exploration licenses in Mongolia and operates the flagship Ovoot Tolgoi coal mine. Ovoot Tolgoi produces and sells coal to customers in China.

SIGNIFICANT EVENTS AND HIGHLIGHTS

The Company's significant events and highlights for the year ended December 31, 2014 and subsequent period to March 30, 2015 are as follows:

- The Company continues to operate under difficult market conditions resulting from strong seaborne and domestic supply coupled with soft demand in China. Chinese coking coal imports fell by 17.2% in 2014 and 12.6% in the fourth quarter of 2014 compared to the same periods last year. Coal prices in China stabilized in the fourth quarter of 2014, mainly due to winter restocking from end users, after hitting seven year lows in the third quarter. However, the gains made in the fourth quarter of 2014 have been erased since the beginning of 2015 due to sluggish demand, which has continued beyond the Chinese New Year holiday. The Company's sales volumes and revenues are expected to remain under pressure through 2015 as Chinese coal import volume and prices continue to decline.
- Production of raw coal by the Company remained low at 0.21 million tonnes in the fourth quarter of 2014 compared to 1.73 million tonnes in the fourth quarter of 2013. This lower production level is due to the Company's decision in June, in response to current market conditions, to reduce its production and place approximately half of its workforce on furlough. This furlough is anticipated to remain in place until market conditions improve.
- On January 7, 2014, the Company reported the public announcement regarding the Ontario Action against certain of the Company's current and former senior officers and directors, and its former auditors, in relation to the Company's restatement of financial statements, as disclosed on November 8, 2013, November 11, 2013, November 14, 2013 and December 12, 2013.
- Messrs. Lindsay Dove and Sean Hinton did not stand for re-election at the Annual General Meeting held on May 6, 2014 and ceased to be directors at that date.
- On May 25, 2014, the Company announced that Turquoise Hill Resources Ltd. ("Turquoise Hill") had agreed to provide a $10 million shareholder loan facility (the "Turquoise Hill Loan Facility").
- On June 20, 2014, the Company announced that the exemption granted to the Company in relation to its secondary listing status on the HKEX in 2010 by the Hong Kong Securities and Futures Commission pertaining to Takeovers, Mergers and Share Repurchases (the "Takeovers Code") had been withdrawn and that the Company would be considered a public company in Hong Kong for matters relating to the Takeovers Code.
- On July 30, 2014, the Company reported that Turquoise Hill had entered into a share purchase agreement ("SPA") with National Resources Holdings Limited ("NUR") to sell Common Shares representing 29.95% of the Company's total issued and outstanding Common Shares.
- On August 26, 2014, the Court of Justice in Mongolia returned the tax investigation case against the Company's subsidiary SouthGobi Sands LLC ("SGS") and three of its former employees to the Prosecutor General for further investigations.
- On August 31, 2014, the Company announced that Turquoise Hill had agreed to a limited deferral of repayment of all funds owing and due by the Company under the Turquoise Hill Loan Facility.
- On September 28, 2014, the Company announced the completion of the construction of a paved coal highway to the Shivee Khuren Border Crossing.
- On November 12, 2014, the Company announced the December 1, 2014, retirement of Ms. Kay Priestly as Chair, the appointment of current independent director Mr. Gordon Lancaster to the position of interim Chair and the appointment of Mr. Jeffery Tygesen as a non-executive director.

SIGNIFICANT EVENTS AND HIGHLIGHTS

- On November 20, 2014, the Company announced that it was delaying the payment of the November 2014 installment of cash interest due to the China Investment Corporation ("CIC") under the terms of the Convertible Debenture (the "November CIC Payment").
- On December 1, 2014, the Company announced that it had entered into private placement and CIC had agreed to extend the cure period agreed for the November CIC Payment to December 4, 2014.
- On December 2, 2014, NUR signed an amendment agreement ("Amendment Agreement") to the previously announced and signed Sale and Purchase agreement dated July 29, 2014 with Turquoise Hill in respect of the sale of 56,102,000 Common Shares of the Company held by Turquoise Hill. In respect of the transaction contemplate, the Amendment Agreement provides, among other matters, for an extension to the closing date from November 30, 2014 to April 30, 2015.
- On December 3, 2014, the Company successfully completed private placements for the issue of 24,360,773 Common Shares for gross proceeds of US$9.0 million (US$8.9 million net after fees) at CAD $0.42 per share.
- On December 4, 2014 Turquoise Hill agreed on a limited deferral of repayment on the $3.8 million principal owing under the Turquoise Hill Loan Facility. The Turquoise Hill Loan Facility matured on August 30, 2014 and is no longer available for further drawdowns by the Company. This limited deferral is subject to certain conditions and limitations, including the completion by April 30, 2015 of the transaction contemplated by the Sale and Purchase Agreement and the Amendment Agreement between Turquoise Hill and NUR.
- On December 12, 2014 the Company announced the stepping down of the President and Chief Executive Officer Ross Tromans, and appointment of Enkh-Amgalan Sengee as President and Chief Executive Officer. Mr. Tromans remained with the Company and on the Board of Directors (the "Board") until December 31, 2014.
- On December 30, 2014 the Company was notified that the Capital City Prosecutor (head of the Capital Prosecutor's Office, Ulaanbaatar, Mongolia) had decided to dismiss the allegations for money laundering against the Company's three former employees. This was consistent with the report issued by the experts appointed by the State Investigations Agency ("SIA") on June 30, 2013 and again in January 2014.
- In respect of the ongoing tax investigation case in Mongolia, on January 30, 2015 the panel of appointed judges from the Second District Criminal Court of Justice found the Company's three former employees guilty of tax evasion and gave sentences ranging from 5 years and 6 months to 5 years and 10 months of imprisonment in the correctional facilities of strict regimen in Mongolia. Although SGS was not a party to the criminal proceedings, the court declared it to be financial liable as a "civil defendant" for a penalty of MNT 35.3 billion (approximately US$18.2 million on February 1, 2015). The Company strongly believes it has not committed tax evasion, firmly rejects the Court's verdict and what have been gross violations of Mongolian law through the investigations and the Court process. Therefore the Company filed an appeal of the Second District Criminal Court of Justice's verdict on February 18, 2015. On February 26, 2015 the President of Mongolia issued a decree of pardon to the three former employees and following the pardon they were released from imprisonment and departed Mongolia. On March 25, 2015, the hearing of the appeal of the Tax Verdict took place. The Tax Verdict was upheld and the appeal by the Company was dismissed. It is the view of the Company that there is a lack of evidence to support both the Tax Verdict and the Appeal Verdict and, accordingly, the Company will continue to defend itself through all available legal means including a final appeal. The Tax Penalty would only be payable after a final appeal.

SIGNIFICANT EVENTS AND HIGHLIGHTS

- On February 24, 2015 the Company announced it had entered into a private placement for proceeds of up to US$7.5 million with Novel Sunrise Investments Limited ("Novel Sunrise") as a proposed new significant investor and strategic partner. The completion of the private placement and related transactions was subject to acceptance of notice of the placement by the Toronto Stock Exchange ("TSX") pursuant to the financial hardship provisions of the TSX Company Manual. As a result of relying on the financial hardship provisions, the Company was placed on remedial delisting review as of February 25, 2015. A meeting of the TSX Continued Listing Committee to consider this matter has been scheduled for May 19, 2015.
- On February 24, 2015 the Company was advised by Turquoise Hill that they had entered into a Sale and Purchase Agreement ("Novel SPA") with Novel Sunrise for the purchase of 48,705,155 Common Shares currently held by Turquoise Hill. The closing of the Novel SPA is subject to certain terms and closing conditions.
- On March 3, 2015 following the successful closing of the first tranche of the Novel Sunrise private placement, including the receipt of US$3.5 million, the Company issued 10,131,113 Mandatory Convertible Units to Novel Sunrise and in accordance with the terms of the agreement Mr. Ted Chan was appointed as the Executive Director of the Company.
- On March 13, 2015, Mr. Enkh-Amgalan Sengee, tendered his resignation as President and Chief Executive Officer. Mr. Ted Chan, assumed the duties formerly handled by Mr. Sengee until further notice.
- On March 18, 2015, the Company announced that Mr. Jeffery Tygesen resigned as a non-executive director.
- As at the date hereof, the Company, together with the new strategic partner, Novel Sunrise, has developed a funding plan in order to pay the interest due under the CIC Convertible Debenture, meet the Company's obligations as they fall due and achieve its business objectives in 2015 and beyond. However, there is no guarantee that the Company will be able to implement this funding plan or secure other sources of financing. See section 6 "Liquidity and Capital Resources" and section 14 "Risk Factors" for details. As at March 30, 2015, the Company had cash of $4.2 million.

W. Gordon Lancaster
Interim Chairman of the Board,
Independent Non-Executive Director

MESSAGE FROM THE INTERIM CHAIRMAN

2014 will not be remembered as a good year for the global coal mining industry. SouthGobi faced more than its fair share of issues and obstacles during the year. While there remains a great deal of work ahead, I feel as though we can at least see a way forward.

MESSAGE FROM THE INTERIM CHAIRMAN

2014 will not be remembered as a good year for the global coal mining industry with SouthGobi facing more than its fair share of issues and obstacles during the year. Therefore, I would like to commence by thanking all the SouthGobi staff for their loyalty, dedication and hard work during this difficult year. While there remains a great deal of work ahead, I feel as though we can at least see a way forward.

In 2014, we continued to encounter challenging market conditions. Today, the Chinese market into which we sell our coal continues to suffer from overcapacity together with decreased demand. These conditions impacted our pricing, product mix and volumes throughout the year and as a result the Company decided to limit its production. This strategy was instrumental in allowing the Company to protect its cash reserves.

In light of these difficulties, our senior management team has been relentless in pursuing cost reduction initiatives and implementing measures that allowed the Company to meet its debt obligations. In addition to keeping its expenditures under control and focusing on prepaid coal offtake contracts, the Company has divested some non-core assets, obtained short term debt financing and successfully completed equity placements for a total of $17.4 million in order to maintain its liquidity. This effort has continued into 2015 and on March 3, we successfully closed the first tranche of a private placement with Novel Sunrise Investments Limited raising $3.5 million. Under the same agreement, we expect to raise an additional $4 million. All of these fund raising activities should be recognized as significant achievements given the market conditions for coal.

In September, the Company announced the construction of the paved highway from the Ovoot Tolgoi Deposit to the Shivee Khuren Board Crossing. We expect commercial operation to commence in the second quarter of 2015. The highway is anticipated to bring multiple benefits to the Company and the local community through significantly increasing the safety of coal transportation, reducing environmental impacts and improving efficiency and capacity of coal transportation into China.

I firmly believe the Company needs to maintain its focus on safety and corporate responsibility. In 2014, the Company only recorded one minor lost time injury and continues to maintain its high safety standards. Further, I am proud to announce on January 23, 2015, we were awarded the “Sustainable Operation of The Year” award by an independent panel of professional judges at the 2014 Mongolian Mining Journal Awards. This award reflects, the efforts by the Company to maintain employment during these difficult conditions in Mongolia, the completion of a paved highway from the Ovoot Tolgoi Deposit to the Shivee Khuren Border Crossing, the excellent implementation of the 2014 environmental protection activities and our corporate social responsibility projects including supporting education, improving medical services, and assisting local communities during the harsh winter.

The Company continues to devote a significant amount of time and resources to the ongoing tax investigations in Mongolia which has attracted both Mongolian and international media attention. The Company has continually demonstrated throughout the investigations and Court process that it had not evaded taxes and we will continue to defend ourselves vigorously through the appeal process. The Company never stopped supporting its three former employees who were barred from leaving Mongolia for over two years. I would like to acknowledge the decision by the President of Mongolia in February, 2015 to grant a pardon to our former employees. We now look to the future with a difficult period for our colleagues and their families behind us.

The Company is going through a major shift in its shareholder base. Turquoise Hill Resources, which owned 56% of the Company at the beginning of 2014, has commenced divesting its shares in SouthGobi. Therefore in 2015 we expect to continue to welcome new strategic partners and investors. I would like to thank Turquoise Hill for their continued support.

As one chapter ends another one begins, and I would like to welcome and introduce Ted Chan from Novel Sunrise Investments Limited to you. Novel Sunrise recently invested $3.5m and Ted joined us as Executive Director on March 3. Your Board and management has already started working with Ted and Novel Sunrise to unlock the Company’s full potential.

On behalf of the Board of Directors, I would like to thank all SouthGobi staff, the communities and authorities of Mongolia, our customers, suppliers and you our shareholders for all your support throughout these challenging times.

W. Gordon Lancaster
Interim Chairman of the Board and
Independent Non-Executive Director

LARGE RESOURCE BASE

Aggregate coal resources include measured and indicated resources of 497 million tonnes and inferred resources of 293 million tonnes


996

BOARD OF DIRECTORS

W. Gordon Lancaster
Interim Chairman of the Board and Independent Non-Executive Director

Mr. Lancaster, 71, joined the Company as an Independent Non-Executive Director on May 11, 2010. He is currently an independent business consultant. Mr. Lancaster was Chief Financial Officer of Ivanhoe Energy Inc., an international heavy-oil development and production company. Prior to joining Ivanhoe Energy Inc. in 2004, he was Chief Financial Officer of Power Measurement Inc., a high-tech company that is a world leader in the design, development, manufacture and marketing of enterprise energy management systems.

Mr. Lancaster is a Chartered Accountant certified by the Institute of Chartered Accountants of British Columbia and, prior to entering industry in 1982 with the First City Group of companies, he had a 20 year career in public accounting with Deloitte & Touche with the last five years as a partner in that firm's Vancouver office. Mr. Lancaster is a member of the Institute of Corporate Directors.

Ted Chan
Executive Director

Mr. Chan, 50, joined the Company as an Executive Director on March 3, 2015. Mr. Chan has over 25 years of enterprise management experience and is currently President of Novel Sunrise which, together with its affiliated companies in China (collectively, the "Novel Group"), is a leading private enterprise in the real estate, logistics and supply chain management industries. Mr. Chan has been with the Novel Group for over 20 years and under his leadership, the Novel Group significantly increased its involvement in the procurement of construction materials and established strong relationships, as a customer, with a number of the leading steel and cement manufacturers in China. Prior to his position with the Novel Group, Mr. Chan was the General Manager for Beijing Wanhai Real Estate Development Co. Ltd, which developed several residential and commercial properties in gateway cities of China. Between 1991 and 1993, Mr. Chan was the Chief Representative of Ocean Trading Corporation for their Beijing office. Ocean Trading Corporation was a US based company overseeing investments and trading activities between China and the United States.

Mr. Chan holds a Bachelor of Art degree from the Communication University of China in Beijing. Mr. Chan is a member of the Institute of Corporate Directors.

BOARD OF DIRECTORS

Pierre Lebel
Independent Non-Executive Director and Lead Director

Mr. Lebel, 65, joined the Company as an Independent Non-Executive Director on August 13, 2003. Mr. Lebel is the Company's Lead Director and served as its Chairman from 2003 until June 2007. He has a distinguished career in mining spanning over 35 years, with a primary focus on mine financing, construction and development. Mr. Lebel currently serves as Chairman and a Director of Imperial Metals Corporation, a TSX-listed mine developer and operator. In 1998, Mr. Lebel was awarded the E.A. Scholz Medal by the British Columbia and Yukon Chamber of Mines for excellence in mine development in British Columbia and was recognized by the Mining Association of British Columbia as its 2012 Mining Person of the Year.

Mr. Lebel holds a Masters of Business Administration from McMaster University and a Bachelor of Laws (LLB) from the University of Western Ontario. He is a retired member of the Law Society of British Columbia. Mr. Lebel is also a member of the Board of Directors of the Mining Association of Canada, the Mining Association of British Columbia, Business Council of BC, the Lions Gate Hospital Foundation and a member of the Institute of Corporate Directors.

André Deepwell
Independent Non-Executive Director

Mr. Deepwell, 60, joined the Company as an Independent Non-Executive Director on August 13, 2003. He has been the Chief Financial Officer and Corporate Secretary of a number of natural resource companies over the last 15 years and is currently Chief Financial Officer and Corporate Secretary of Imperial Metals Corporation, a TSX-listed mine developer and operator. Mr. Deepwell has been involved in all aspects of debt and equity financings and financial reporting for mining enterprises ranging from grassroots exploration to mine development and production.

Mr. Deepwell is a Chartered Accountant, certified by the Institute of Chartered Accountants of British Columbia, and a graduate of the University of British Columbia. He holds a Bachelor of Commerce with majors in Accounting and Finance. Mr. Deepwell is a member of the Institute of Corporate Directors.

BOARD OF DIRECTORS

Bold Baatar
Non-Executive Director

Mr. Bold, 41, joined the Company as a Non-Executive Director on September 3, 2013. Mr. Bold is currently Managing Director, Marine, Rio Tinto, and a member of the Executive Committee of Rio Tinto Iron Ore. Prior to this position, Mr. Bold was President, International Operations of Rio Tinto's Copper group where he oversaw a diverse portfolio of underground copper mining operations at Northparkes, Australia and Palabora, South Africa as well as greenfiled investments in Sulawesi Nickel, Indonesia and indirect interests in Pebble through Northern Dynasty. Before joining Rio Tinto, Mr. Bold held CEO level positions of a gold mining and exploration Company and an investment conglomerate in Mongolia. Mr. Bold spent over 10 years in senior-level investment banking positions at JPMorgan in New York, London and Moscow where he acquired extensive experience in leveraged buyouts, debt and equity capital markets and mergers & acquisitions.

Mr. Bold holds a Bachelor of Industrial Engineering degree from the Mongolian Technical University and a Masters of Business Administration from the University of Bridgeport, United States. Mr. Bold is also a member of the Institute of Corporate Directors.

Kelly Sanders
Non-Executive Director

Mr. Sanders, 57, joined the Company as a Non-Executive Director on September 3, 2012. He is currently the President and Chief Executive Officer of the Rio Tinto Iron Ore Company of Canada. Prior to accepting his most recent position, Mr. Sanders served as the Managing Director, HME2014, Rio Tinto. Mr. Sanders has worked in the mining industry for over 35 years, including 28 years involved with coal mining operations. Mr. Sanders previously held senior positions with Rio Tinto's Kennecott Utah Copper operations, Rio Tinto Energy America and Ziegler Coal.

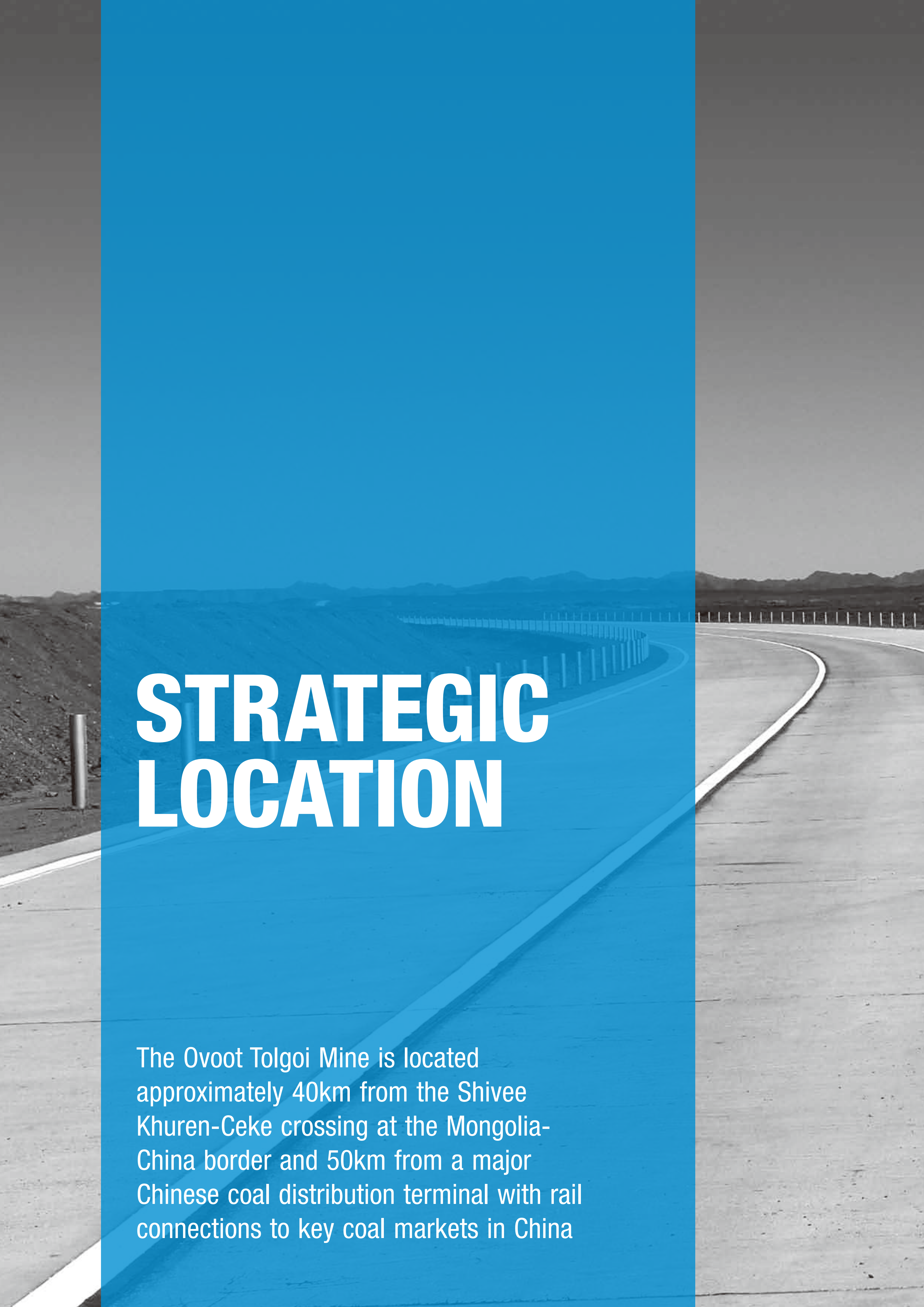
Mr. Sanders holds a Bachelor of Science in Agronomy from Purdue University. He is a past Executive Board member with the National Mining Association, the Copper Development Association, the Utah Museum of Natural History and the Salt Lake City Chamber of Commerce. Mr. Sanders is also a member of the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

SENIOR MANAGEMENT

Bertrand Troiano
Chief Financial Officer

Mr. Troiano, 41, joined the Company as Chief Financial Officer on April 8, 2013. Prior to joining the Company, Mr. Troiano was Finance Director for Rio Tinto Alcan's Business Development, Major Projects and Technology group. Mr. Troiano began his career in corporate banking with BNP-Paribas in Japan and has spent the past 13 years in finance roles in the mining and metals industry. During this time, he worked for Pechiney, Alcan and Rio Tinto in the United States, the Netherlands and Canada.

He has a Master's degree in Business from Ecole Superieure de Commerce de Paris and holds a Masters of Business Administration from Columbia University in New York and London Business School.



STRATEGIC LOCATION

The Ovoot Tolgoi Mine is located approximately 40km from the Shivee Khuren-Ceke crossing at the Mongolia-China border and 50km from a major Chinese coal distribution terminal with rail connections to key coal markets in China

DIRECTOR'S REPORT

The Board of Directors (the "Board") of SouthGobi Resources Ltd. is pleased to present their report along with the audited consolidated financial statements (the "Financial Statements") of SouthGobi Resources Ltd. together with its subsidiaries (collectively the "Company") for the financial year ended December 31, 2014 ("Financial Year").

Principal activities and geographical analysis of operations

The Company is an integrated coal mining, development and exploration company. The Company's principal subsidiaries are set out in Note 27 of the Financial Statements and the activities of all subsidiaries of the Company at December 31, 2014 are set out in the table below:

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

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

Results

The results of the Company for the Financial Year are set out in the Consolidated Statement of Comprehensive Income on page 108.

Dividends

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

Property, plant and equipment

Details of the movement in the property, plant and equipment of the Company during the Financial Year are set out in Note 15 of the Financial Statements.

Share capital

Details of the movement in the share capital of the Company during the Financial Year are set out in the Consolidated Statement of Changes in Equity on page 110.

Neither the Company, nor any of its subsidiaries purchased or redeemed any of the Company's listed securities during the year.

Reserves

Details of the reserves available for distribution to the shareholders as at December 31, 2014 are set out in the Consolidated Statement of Changes in Equity on page 110.

Directors

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

Independent Non-Executive Directors

Mr. W. Gordon Lancaster (1) *(Interim Chairman)*
Mr. Pierre Lebel *(Lead Director)*
Mr. André Deepwell

Executive Director

Current:

Mr. Ted Chan (2)

Past:

Mr. K. Ross Tromans (3)

Non-Executive Directors

Current:

Mr. Bold Baatar
Mr. Kelly Sanders

Past:

Mr. Jeffery Tygesen (4)
Ms. Kay Priestly (5)
Mr. Sean Hinton (6)
Mr. Lindsay Dove (7)

Notes:

(1) Mr. Lancaster was appointed Interim Chairman on December 1, 2014
(2) Mr. Chan was appointed to the Board of Directors and Executive Director position on March 3, 2015
(3) Mr. Tromans resigned from the Board on December 31, 2014
(4) Mr. Tygesen joined the Board on December 1, 2014 and resigned on March 17, 2015
(5) Ms. Priestly resigned as Chairman and from the Board on December 1, 2014
(6) Mr. Hinton did not stand for re-election and ceased to be a Director on May 6, 2014
(7) Mr. Dove did not stand for re-election and ceased to be a Director on May 6, 2014

Except where such director has already resigned from the Board, the term of office for each of the directors will end at the conclusion of the forthcoming annual general meeting. In accordance with article 14.1 of the articles of continuation for the Company, each of the directors, including the independent non-executive directors, are subject to retirement and re-election annually at the annual general meeting.

Directors' service contracts

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

Directors' interests in contracts of significance

No contracts of significance to which the Company was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at December 31, 2014 or at any time during the Financial Year.

Directors' interests in competing businesses

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

DIRECTOR'S REPORT

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

At December 31, 2014, or in the case of departed directors and senior management as at their resignation date, the interests of the directors and senior management in the shares and share options of the Company and its associated corporations were as follows:

Shares

Name	Name of company	Nature of Interest	Shares held	Approximate % interest in the company
Bold Baatar (1)	SGQ	N/A	Nil	Nil
	TRQ	N/A	Nil	Nil
	Rio Tinto plc	Direct	17,757	0.00%
André Deepwell (2)	SGQ	Direct/Indirect	45,000	0.00%
	TRQ	N/A	Nil	Nil
	RTZ	N/A	Nil	Nil
W. Gordon Lancaster	SGQ	N/A	Nil	Nil
	TRQ	N/A	Nil	Nil
	RTZ	N/A	Nil	Nil
Pierre Lebel	SGQ	Direct	5,100	0.00%
	TRQ	N/A	Nil	Nil
	RTZ	N/A	Nil	Nil
Kelly Sanders (3)	SGQ	N/A	Nil	Nil
	TRQ	N/A	Nil	Nil
	Rio Tinto plc	Direct	82,447	0.00%
Jeffery Tygesen (4)	SGQ	N/A	Nil	Nil
	TRQ	N/A	Nil	Nil
	Rio Tinto plc	Direct	22,482	0.00%
K. Ross Tromans (5)	SGQ	N/A	Nil	Nil
	TRQ	N/A	Nil	Nil
	Rio Tinto Limited	Direct	24,515	0.00%
Bertrand Troiano	SGQ	N/A	Nil	Nil
	TRQ	N/A	Nil	Nil
	Rio Tinto Limited	Direct	4,779	0.00%
Enkh-Amgalan Sengee	SGQ	N/A	Nil	Nil
	TRQ	N/A	Nil	Nil
	RTZ	Direct	Nil	Nil
Sean Hinton	SGQ	N/A	Nil	Nil
	TRQ	N/A	Nil	Nil
	RTZ	N/A	Nil	Nil
Lindsay Dove (6)	SGQ	N/A	Nil	Nil
	TRQ	N/A	Nil	Nil
	Rio Tinto Limited	Indirect	11,000	0.00%
Kay Priestly (7)	SGQ	N/A	Nil	Nil
	TRQ	Direct	12,000	0.00%
	Rio Tinto plc	Direct	56,472	0.00%
Brett Salt (8)(9)	SGQ	N/A	Nil	Nil
	TRQ	Direct	Nil	Nil
	Rio Tinto plc	Direct	1,675	0.00%
	Rio Tinto Limited	Direct	2,081	0.00%

(1) includes 17,757 unvested shares
(2) included 45,000 shares held by the spouse of Mr. Deepwell
(3) includes 30,778 vested shares and 51,669 unvested shares
(4) includes 7,629 vested shares and 14,853 unvested shares
(5) includes 14,121 vested shares and 10,394 unvested shares
(6) includes 11,000 shares held by the spouse of Mr. Dove
(7) includes 23,358 vested and 33,114 unvested options in Rio Tinto plc
(8) includes 1,675 unvested shares in Rio Tinto plc
(9) includes 1,602 vested shares and 479 unvested shares in Rio Tinto Limited

Share Options

Name	Name of company	Number of Options held
Bold Baatar	SGQ	Nil
	TRQ	Nil
	RTZ	Nil
André Deepwell	SGQ	367,352
	TRQ	Nil
	RTZ	Nil
W. Gordon Lancaster	SGQ	477,352
	TRQ	Nil
	RTZ	Nil
Pierre Lebel	SGQ	372,352
	TRQ	Nil
	RTZ	Nil
Kelly Sanders	SGQ	Nil
	TRQ	Nil
	Rio Tinto plc	9,601
Jeffery Tygesen	SGQ	Nil
	TRQ	Nil
	Rio Tinto plc	3,422
K. Ross Tromans	SGQ	Nil
	TRQ	Nil
	Rio Tinto Limited	4,284
Bertrand Troiano	SGQ	Nil
	TRQ	Nil
	RTZ	Nil
Enkh-Amgalan Sengee	SGQ	194,554
	TRQ	Nil
	RTZ	Nil
Sean Hinton	SGQ	102,000
	TRQ	Nil
	RTZ	Nil
Lindsay Dove	SGQ	50,000
	TRQ	Nil
	RTZ	Nil
Kay Priestly	SGQ	Nil
	TRQ	Nil
	Rio Tinto plc	6,298
Brett Salt	SGQ	642,077
	TRQ	Nil
	RTZ	Nil

Other than the holdings disclosed in the preceding tables, none of the directors, senior management and their associates had any interests or short positions in any shares, underlying shares or debentures of the Company or of its associated corporations as at December 31, 2014.

Management contracts

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

DIRECTOR'S REPORT

Share option plan

The particulars of the Company's share option plan are set out in Note 23 of the Financial Statements. The following table discloses movements in the Company's share options for the Financial Year:

Name	Outstanding at beginning of year	Granted during the year	Exercise Price (Cdn$)	Exercised during the year	Forfeited during the year	Expired during the year	Outstanding at year-end
Mr. Bold Baatar	–	–	–	–	–	–	–
Mr. Ted Chan	–	–	–	–	–	–	–
Mr. André Deepwell	145,000	257,352	$0.58	–	–	(35,000)	367,352
Mr. Lindsay Dove	50,000	–	–	–	(50,000)	–	–
Mr. Sean Hinton	112,000	–	–	–	(112,000)	–	–
Mr. W. Gordon Lancaster	220,000	257,352	$0.58	–	–	–	477,352
Mr. Pierre Lebel	150,000	257,352	$0.58	–	–	(35,000)	372,352
Ms. Kay Priestly	–	–	–	–	–	–	–
Mr. Kelly Sanders	–	–	–	–	–	–	–
Mr. Jeffery Tygesen	–	–	–	–	–	–	–
Mr. K. Ross Tromans	–	–	–	–	–	–	–
Mr. Brett Salt	150,000	492,077	$0.58	–	–	–	642,077
Mr. Enkh-Amgalan Sengee	70,000	123,554	$0.58	–	–	–	194,554
Mr. Bertrand Troiano	–	–	–	–	–	–	–
Total for directors and senior management	897,000	1,387,687	$0.58	–	(162,000)	(70,000)	2,053,687
Total for other share option holders	1,686,564	535,859	$0.58	–	(1,095,865)	(127,000)	1,686,562
Total	2,583,564	1,923,546	$0.58	–	(1,257,865)	(197,000)	3,052,245

Details of the accounting policy for the Company's share option plan are set out in Note 3.10 of the Financial Statements.

Arrangement to purchase shares and debentures

Eligible directors, employees and members of management are able to participate in the Company's share purchase plan, which allows participants to contribute up to 7% of their basic annual salary to purchase shares in the Company. The Company contributes 50% of the participant's contribution and at the end of each calendar quarter shares are purchased on behalf of the participant.

Substantial shareholders

The register of interests in shares and short positions of the Company showed that as at December 31, 2014, the Company has been notified of the following interests in shares representing 5% or more of the Company's issued share capital:

Name	Nature of interest	Shares held	Approximate % of issued shares
Turquoise Hill Resources Ltd.	Beneficial	104,807,155	47.91%
China Investment Corporation	Beneficial	30,849,444	14.10%
China Wish Limited	Beneficial	20,880,663	9.55%

Other than as disclosed above, the Company has not been notified of any relevant interests or short positions in the issued share capital of the Company as at December 31, 2014.

Emolument policy

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

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

The Company has also adopted an equity incentive plan to incentivize directors and eligible employees. Details of the plan are set out in Note 23 of the Financial Statements.

Pre-emptive rights

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

Sufficiency of public float

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

Major customers and suppliers

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

Purchases

The largest supplier accounted for 19% of the Company's purchases.

The five largest suppliers accounted for 54% of the Company's purchases.

Sales

The largest customer accounted for 34% of the Company's sales.

The six largest customers accounted for 100% of the Company's sales.

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

Charitable donations

During the Financial Year the Company made charitable donations amounting to US$106,622.

Events after reporting period

Details of events occurring after December 31, 2014 are set out in Note 30.1 and Note 31 of the Financial Statements.

Independent auditor

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

On behalf of the Board

W. Gordon Lancaster
Interim Chairman of the Board,
Independent Non-Executive Director
March 30, 2015

CORPORATE GOVERNANCE REPORT

Corporate Governance

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

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

- approved and adopted a mandate for the Board, which sets out its stewardship responsibilities;
- appointed Mr. Pierre Lebel, an independent non-executive director, as "Lead Director", with the specific responsibility of, among other things, maintaining the independence of the Board and ensuring the Board carries out its responsibilities mandated by applicable statutory and regulatory requirements and stock exchange listing standards;
- appointed an Audit Committee (composed of independent directors), a Nominating and Corporate Governance Committee (composed of independent and non-executive directors), a Compensation and Benefits Committee composed of independent directors), a Health, Environment, Safety and Social Responsibility Committee (composed of non-executive and executive directors);
- approved charters for the Audit, Nominating and Corporate Governance, Compensation and Benefits, and Health, Environment, Safety and Social Responsibility Board committees;
- established a management Disclosure Committee for the Company, with the mandate to oversee the Company's disclosure practices;
- formalized the Company's Corporate Disclosure, Confidentiality and Securities Trading Policy;
- adopted formalized written position descriptions for the Chairman, Lead Director, Executive Director and CFO, as well as the Chairs of the Audit, Compensation and Benefits and Nominating and Corporate Governance Committees clearly defining their respective roles and responsibilities;
- adopted and implemented a more robust compliance program for all Directors and employees; including business integrity policies and the Speak-Out whistleblower program;
- formalized a process for assessing the effectiveness of the Board as a whole, the committees of the Board and the contribution of individual directors, on a regular basis; and
- adopted an executive compensation model for the Company.

Compliance with Corporate Governance

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

In December 2012 the Company approved the adoption and implementation of a compliance program based on a Rio Tinto Group model. Throughout 2013 and 2014 additional Business Integrity standards have been adopted, including Anti-bribery, Anti-corruption, Dawn Raid Guidelines, Conflict of Interest Policies and Guidelines for the investigation into allegations of serious wrongdoing (collectively "Code of Conduct Standards"), and the Speak-Out program.

The Code of Conduct Standards provides that the Company's employees, consultants, officers and directors will uphold its commitment to a culture of honesty, integrity and accountability and that the Company requires the highest standards of professional and ethical conduct from its employees, consultants, officers and directors. The various policies forming the Code of Conduct Standards are available on the Company's website (www.southgobi.com) and a copy of the Company's Code of Conduct Standards may be obtained, without charge, by request to SouthGobi Resources Ltd., 354 – 200 Granville Street, Vancouver, British Columbia, Canada V6C 1S4, Attention: Corporate Department, or by phone to 604-681-6799.

Speak-Out is the Company whistleblowing service and it is available for use when someone suspects or is aware of illegal, unsafe or inappropriate activity at work. Speak-Out provides avenue for employees to raise concerns confidentially and anonymously.

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

Board Composition

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

Based on information regarding personal and business circumstances provided in a comprehensive questionnaire completed annually by each of the Company's directors and reasonable enquiry of the Board to determine whether or not the members of the Board are independent, the Company's Board is satisfied that three (3) of its six (6) current members representing 50% of all Board members are independent.

Although a majority of the board members are not independent, five (5) of the six (6) directors are non-executive directors. In the event the board must consider a potential or actual conflict, such matter is referred to the independent directors to ensure processes are in place to receive independent scrutiny. To facilitate the exercise of independent judgment, the independent and non-executive members of the Board meet regularly. In 2014, the independent non-executive directors met two (2) times and the non-executive directors met four (4) times.

Independent Non-Executive Directors	Non-Independent Directors
Mr. W. Gordon Lancaster *(Interim Chair)*	**Current**
Mr. Pierre Lebel *(Lead Director)*	Mr. Ted Chan (1)
Mr. André Deepwell	Mr. Bold Baatar (2)
	Mr. Kelly Sanders (3)
	Past
	Mr. Jeffery Tygesen (4)
	Ms. Kay Priestly (5)
	Mr. Ross Tromans (6)
	Mr. Lindsay Dove (7)
	Mr. Sean Hinton (7)

Notes:

(1) Mr. Chan is the Company's Executive Director.

(2) Mr. Baatar is a senior officer of Rio Tinto Copper group.

(3) Mr. Sanders is President and Chief Executive Officer of the Rio Tinto Iron Ore Company of Canada.

(4) Mr. Tygesen, Chief Executive Officer of Turquoise Hill, resigned from the Board on March 17, 2015.

(5) Ms. Priestly resigned from the Board of Directors on December 1, 2014.

(6) Mr. Tromans resigned from the Board of Directors on December 31, 2014.

(7) Messrs. Dove and Hinton did not stand for re-election at the May 6, 2014 annual general meeting.

As at March 30, 2015, Turquoise Hill held approximately 47.9% of the Company's issued and outstanding common shares. The Board has determined that Messrs. Lebel, Deepwell and Lancaster are independent directors.

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

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

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

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

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

Mandate of the Board

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

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

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

CORPORATE GOVERNANCE REPORT

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

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

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

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

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

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

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

Committees of the Board

Audit Committee

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

The Company's Audit Committee consists of Messrs. Deepwell, Lebel and Lancaster. Mr. Deepwell is the chairman of the Audit Committee.

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

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

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

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

The Audit Committee held four (4) meetings during the Financial Year. In performing its duties in accordance with the Audit Committee Charter, the Audit Committee has:

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

Nominating and Corporate Governance Committee

The Board has established a Nominating and Corporate Governance Committee, which operates under a charter approved by the Board. The primary objective of the Nominating and Corporate Governance Committee is to assist the Board in fulfilling its oversight responsibilities by (a) identifying individuals qualified to become Board and committee of the Board members and recommending that the Board select director nominees for appointment or election to the Board; and (b) developing and recommending to the Board corporate governance guidelines for the Company and making recommendations to the Board with respect to corporate governance practices. The Nominating and Corporate Governance Committee monitors the disclosure of conflicts of interest to the Board and ensures that no director will vote or participate in a discussion on a matter in respect of which such director has a material interest. Committee Chairs perform the same function with respect to meetings of each Board committee.

The members of the Nominating and Corporate Governance Committee are Messrs. Lebel, Deepwell, and Lancaster. Mr. Lebel is the chairman of the Nominating and Corporate Governance Committee. Mr. Tygesen was a member of the Nominating and Corporate Governance Committee from December 1, 2014 to March 17, 2015. Ms. Priestly ceased to be a member of the Nominating and Corporate Governance Committee on December 1, 2014. Mr. Hinton did not stand for re-election and ceased to be a member of the Nominating and Corporate Governance Committee on May 6, 2014.

During the course of 2014, the Nominating and Corporate Governance Committee met five (5) times. In performing its duties in accordance with the Nominating and Corporate Governance Committee Charter, the Nominating and Corporate Governance Committee has:

- reviewed the Nominating and Corporate Governance Committee charter to ensure the Company has the appropriate procedures and processes in place to facilitate the nomination of Directors;
- reviewed the structure, size and composition (including the skills, knowledge and experience) of the Board;
- made recommendations to the Board on the selection of individuals nominated for directorship in view of their qualifications and related expertise;
- made recommendations to the Board on the selection of individuals nominated for senior management roles;
- evaluated the Company's executive management succession plans;

CORPORATE GOVERNANCE REPORT

- ensured that the Board has the necessary structures and procedures so that it can function with an appropriate degree of independence from management;
- provided a forum without management present to receive expressions of concern, including any concern regarding matters involving the independence of the Board from management;
- re-established and conducted induction programs for new Directors; and
- reviewed the practices and procedures of the Board in light of ongoing developments in regulatory requirements and industry best practices in matters of corporate governance and recommended to the Board any changes considered necessary or desirable.

Compensation and Benefits Committee

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

The members of the Compensation and Benefits Committee are Messrs. Lancaster, Deepwell and Lebel. Mr. Lancaster is the chairman of the Compensation and Benefits Committee. Mr. Dove did not stand for re-election and ceased to be a member of the Compensation and Benefits Committee on May 6, 2014.

During the course of 2014, the Compensation and Benefits Committee met three (3) times. In performing its duties in accordance with the Compensation and Benefits Committee Charter, the Compensation and Benefits Committee has:

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

Health, Environment, Safety and Social Responsibility Committee

The Board has established a Health, Environment, Safety and Social Responsibility ("HESS") Committee. The primary objective of the HESS Committee is to review and oversee the Company's established HESS policies and procedures at the Company's project sites. The HESS Committee also reviews any incidents that occur and provides guidance on how to prevent any recurrences.

The members of the HESS Committee are Messrs. Sanders, Baatar and Chan. Mr. Sanders is the chairman of the HESS Committee. Mr. Chan joined the HESS Committee on March 17, 2015. Mr. Tromans ceased to be a member of the HESS Committee on December 31, 2014. Mr. Dove did not stand for re-election and ceased to be a member of the HESS Committee on May 6, 2014.

Mergers and Acquisitions Committee

The Board had established a Mergers and Acquisitions ("M&A") Committee. The primary objective of the M&A Committee was to review, assess and provide guidance on all potential acquisitions, divestitures and strategic investment transactions to which the Company may become a party. As result of the Independent Directors overseeing the Company's interests in potential, future merger and acquisition transactions, the M&A Committee is inactive at this time and did not meet in 2014.

Ad Hoc/Special Committees

In appropriate circumstances, the Board may establish a special committee to review a matter in which several directors or management may have a conflict of interest. In 2014, a Special Committee composed of the Company's Independent Directors was formed to oversee the Company's interests in proposed transactions between Turquoise Hill and interested parties. The Special Committee continues to meet as required.

Through its Audit Committee (comprised solely of independent directors), the Company conducted an internal investigation into possible breaches of law, internal corporate policies and codes of conduct arising from the allegations which have been raised in the context of the investigations by the Mongolian authority. In addition the Chair of the Audit Committee participated in a tripartite committee, comprised of the Audit Committee Chairs of the Company and Turquoise Hill and a representative of Rio Tinto, focused on the investigation of a number of those allegations, including possible violations of anti-corruption laws. Independent legal counsel and other appropriate independent experts were engaged to assist with investigations.

The tripartite committee completed its investigation in October 2013. The investigation concluded there was no evidence to substantiate the allegations raised by the Mongolian authorities. However the Company, through its Board of Directors and new management, has taken a number of steps to address issues noted during the investigations and 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.

Following the conclusion of the internal investigations, the need for the tripartite committee was suspended pending further review or questions from any relevant regulatory authority.

Meetings of the Board and Committees of the Board

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

During the Financial Year, 17 meetings of the Board of Directors, four (4) meetings of the Audit Committee, five (5) meetings of the Nominating and Corporate Governance Committee, three (3) meetings of the Compensation and Benefits Committee and five (5) meetings of the Health, Environment, Safety and Social Responsibility Committee were held. The Mergers and Acquisitions Committee was inactive in 2014 and no meetings were held. Attendance by directors at the board and Committee meetings is shown below:

Attendance record for the Board and Board Committee meetings during the Financial Year	Board meetings	Audit committee meetings	Nominating and Corporate Governance committee meetings	Compensation and Benefits committee meetings	Health, Environment, Safety and Social Responsibility committee meetings	Mergers and Acquisitions committee meetings (1)
	(Number of Attendances/Number of Meetings)					
Executive Directors						
Current						
Mr. Ted Chan (2)	N/A	N/A	N/A	N/A	N/A	N/A
Executive Directors						
Past						
Mr. K. Ross Tromans (3)	16/17	N/A	N/A	N/A	5/5	N/A
Independent Non-Executive Directors						
Mr. W. Gordon Lancaster (8) *(Interim Chairperson)*	16/17	4/4	5/5	3/3	N/A	N/A
Mr. Pierre Lebel *(Lead Director)*	14/17	3/4	4/5	3/3	N/A	N/A
Mr. André Deepwell	17/17	4/4	5/5	3/3	N/A	N/A
Non-Executive Directors						
Current						
Mr. Bold Baatar (4)	15/17	N/A	N/A	N/A	2/3	N/A
Mr. Kelly Sanders	14/17	N/A	N/A	N/A	5/5	N/A
Non-Executive Directors						
Past						
Mr. Jeffery Tygesen (5)	N/A	N/A	N/A	N/A	N/A	N/A
Ms. Kay Priestly (6) *(former Chairperson)*	17/17	N/A	4/5	N/A	N/A	N/A
Mr. Lindsay Dove (7)	3/3	N/A	N/A	2/2	2/3	N/A
Mr. Sean Hinton (7)	3/3	N/A	1/2	N/A	N/A	N/A

Notes:

1) The Mergers and Acquisitions Committee is inactive and no meetings were held in 2014.
2) Mr. Chan joined the Board of Directors on March 3, 2015.
3) Mr. Tromans resigned as a Director of the Company effective December 31, 2014.
4) Mr. Baatar joined the Health, Environment, Safety and Social Responsibility Committee on March 18, 2014.
5) Mr. Tygesen joined the Board of Directors on December 1, 2014.
6) Ms. Priestly resigned as a Director and Chairperson of the Company effective December 1, 2014.
7) Messrs. Dove and Hinton did not stand for re-election and ceased to be a Director on May 5, 2014.
8) Mr. Lancaster was appointed Interim Chairperson on December 1, 2014.

The meeting of the shareholders of Company held on May 6, 2014 was attended by Messrs. Baatar, Deepwell, Lancaster, Lebel, Priestly, Sanders and Tromans. Messrs. Chan and Tygesen were not members of the Board at the time of this meeting.

Professional Development

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

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

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

All Directors are members of the Canadian Institute of Corporate Directors and have the opportunity to attend courses relevant to the Company and its business, particularly with respect to corporate governance and the mining industry, at the Company's expense.

Ethical Business Conduct

In 2012 the Company adopted the implementation of a revised Code of Business Conduct and Ethics (the "Ethics Policy") based on the Rio Tinto model "*The Way We Work*". The Ethics Policy is applicable to all employees, consultants, officers and Directors regardless of their position in the organization, at all times and everywhere the Company does business.

In addition to "*The Way We Work*", the Company has continued to adopt additional guidance notes and standards which form part of the Company's overall Ethics Policy. The guidance notes and standards adopted include: Guidelines for investigations into allegations of serious wrongdoing, Dawn raid guidance notes, Anti-bribery due diligence guidelines, Business Integrity standards relating to anti-corruption and conflicts of interest (collectively "Code of Conduct Standards"), and the Speak-Out program.

Speak-Out is the Company's whistleblowing service and it is available for use whenever someone suspects or is aware of illegal, unsafe or inappropriate activity at work. Speak-Out provides an avenue for employees to raise concerns confidentially and anonymously.

The Ethics Policy and the Code of Conduct Standards provides that the Company's employees, consultants, officers and Directors will uphold its commitment to a culture of honesty, integrity and accountability and that the Company requires the highest standards of professional and ethical conduct from its employees, consultants, officers and Directors. A copy of "*The Way We Work*" and the various policies forming the Code of Conduct Standards are available on the Company's website (www.southgobi.com) and may be obtained, without charge, by request to SouthGobi Resources Ltd., 354 – 200 Granville Street, Vancouver, British Columbia, Canada V6C 1S4, Attention: Corporate Department, or by phone to 604-681-6799.

The Audit Committee monitors compliance with the Code of Conduct Standards. The Nominating and Governance Committee monitors the disclosure of conflicts of interest by Directors with a view to ensuring that no Director votes or participates in any Board deliberations on a matter in respect of which such Director has a material interest.

Appointment and Re-election of Directors

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

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

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

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

Securities Transactions by Directors

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

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

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

Remuneration of Directors

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

All non-executive directors receive Cdn$25,000 per annum for acting as such. Mr. Lancaster, in the capacity of Interim Chairman, and Mr. Lebel, in the capacity of Lead Director, each receive an additional fee of Cdn$60,000 per annum. Mr. Deepwell in the capacity of Chairman of the Audit Committee receives an additional fee of Cdn$40,000 per annum. The Chairs of the Compensation and Benefits Committee, Corporate Governance and Nominating Committee and Health, Environment, Safety and Social Responsibility Committee each receive an additional fee of Cdn$25,000 per annum for acting in such capacity. The Mergers and Acquisitions Committee was inactive in 2014; however, the Chair of the Mergers and Acquisitions Committee would be entitled to receive an additional fee of Cdn$25,000 per annum for acting in such capacity. Mr. Chan, in the capacity of Executive Director, receives a fee of C$65,000 per annum.

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

In the ordinary course, non-executive directors, other than Rio Tinto[1] seconded employees and Rio Tinto nominees to the boards of directors of subsidiary companies, receive an annual grant of incentive stock options in addition to their cash compensation. In 2014, Messrs. Deepwell, Lancaster and Lebel each received a grant of 257,352 stock options per annum, such options having a five-year term and fully vesting on the first anniversary of the date of the grant.

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

Note:

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

Internal Controls

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

The Board conducts annual reviews of the internal controls of the Company to ensure that internal control policies and procedures are adequate. On an ongoing basis, the Directors review the adequacy of the Company's resources, staff qualifications and experience, training programs and budget of the Company's accounting and financial reporting function. The Audit Committee reviewed the effectiveness of the Company's internal control policies as at December 31, 2014, and is of the view that the internal control system in place is effective in safeguarding the investment of shareholders and assets of the Company.

CORPORATE GOVERNANCE REPORT

Auditors

PricewaterhouseCoopers LLP is the auditor of the Company and is independent within the meaning of the Rules of Professional Conduct of the Institute of Chartered Accountants of British Columbia. The financial reporting responsibilities and audit report of the independent auditors are set out on page 107.

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

Fees paid/payable to the external auditors, PricewaterhouseCoopers LLP, in respect of audit and non-audit services provided during the year ended December 31, 2014 are as follows:

Nature of services rendered	Fees paid/payable (C$000's)
Audit fees (a)	453
Audit related fees (b)	165
Other fees	2
Total	620

Notes:

(a) Includes audit fees and audits of subsidiaries

(b) Includes interim reviews

Responsibilities in Respect of the Financial Statements

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

Company Secretary

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

Shareholders' Rights

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

How Shareholders can convene an Extraordinary General Meeting

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

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

Procedures by which enquiries may be put to the Board

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

Procedures for putting forward proposals at Shareholders' Meetings

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

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

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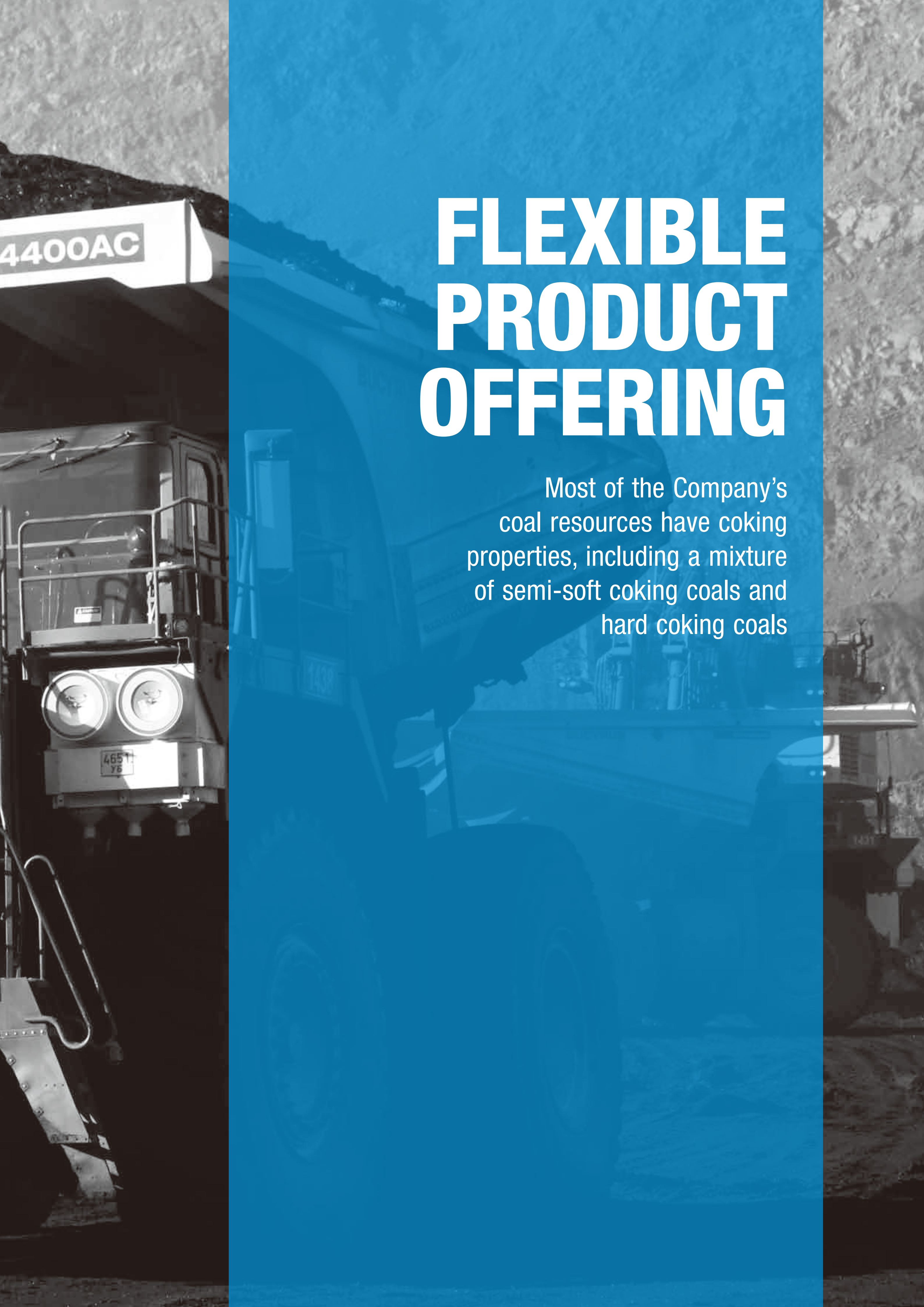

FLEXIBLE PRODUCT OFFERING

Most of the Company's coal resources have coking properties, including a mixture of semi-soft coking coals and hard coking coals

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

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", "could", "should", "seek", "likely", "estimate" 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 times 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 statements include, but are not limited to, statements regarding: anticipated stock market conditions; future prices of the Common Shares; the future ownership of Common Shares; anticipated business activities; planned expenditures; corporate strategies, the Company's intention to develop markets for its semi-soft coking coal brands and to pursue long-term supply offtake with end users in the People's Republic of China ("China"); potential future agreements with third parties; anticipated capital expenditures; the 2015 exploration program; anticipated financing needs; development plans; future production; expected impacts of the administrative restrictions on certain of the Company's Mongolian assets and the anticipated impact on the Company's activities; the impact of future disclosure of the results of the internal investigations being conducted by the Company's Audit Committee; the results of the Ontario Action (as defined under the heading "REGULATORY ISSUES AND CONTINGENCIES – Contingencies – Class Action Lawsuit" in this Management Discussion and Analysis of Financial Condition and Results of Operations ("MD&A")); the ability of the Company to pay the Tax Penalty (as defined under the heading "REGULATORY ISSUES AND CONTINGENCIES – Regulatory Issues – Governmental and Regulatory Issues" in this MD&A); the possible consequences of the Tax Verdict (as defined under the heading "REGULATORY ISSUES AND CONTINGENCIES – Regulatory Issues – Governmental and Regulatory Issues" in this MD&A) and the Appeal Verdict (as defined under the heading "REGULATORY ISSUES AND CONTINGENCIES – Regulatory Issues – Governmental and Regulatory Issues" in this MD&A) and the effect thereof on the Company; the possibility that the Supreme Court of Mongolia would hear a final appeal of the Tax Penalty and the likelihood of success and consequences of the final appeal of the Tax Penalty and the effect thereof on the Company; the potential effect of the list of licenses published by the Government of Mongolia covering areas in which exploration and mining is purportedly prohibited on the Company's mining licenses; the Company's expectations of sufficient liquidity and capital resources to meets its ongoing obligations and future contractual commitments, including the Company's ability to secure additional funding and to meet its obligations under the China Investment Corporation ("CIC") convertible debenture (the "CIC Convertible Debenture") as the same become due; the estimates and assumptions included in the Company's impairment analysis and the possible impact of changes thereof; possible impact of changes to the inputs to valuation model used to value the embedded derivatives in the CIC Convertible Debenture; the possible impacts of changes to assumptions and determinations used by the Company to determine carrying values and impairment charges; possible impacts of changes in useful life or depreciation rates on depreciation expenses; the potential effects of a difference between future cash flows and profits from estimates; the ability of the Company to increase its market penetration in China; estimates of the Company's mineral reserves and resources; the ability for higher-ash product to be sold as a thermal coal product; the type of coal products being produced; the ability to preserve liquidity and continue on a sustainable basis; the ability of the Company to meet the targeted annual capacity of run-of-mine production; the anticipated increase of production from the Ovoot Tolgoi Mine (as defined under the heading "OVERVIEW" in this MD&A) to anticipated annual capacity of 9 million tonnes run-of-min production; the ability of the Company to successfully review the utilization of the wet washing facility and enhance the quality of its coal products through a beneficiation process based on wet washing; the Company's review of the use of the dry coal handling facility ("DCHF") (as defined under the heading "OVERVIEW OF OPERATIONAL DATE AND FINANCIAL RESULTS – Overview of Quarterly Financial Results" in this MD&A) and plans regarding the use of the DCHF; the agreement with Ejin Jinda and payments thereunder; the future mining operations at the Soumber Deposit (as defined under the heading "PROPERTIES – Development Projects and Exploration Program – Soumber Deposit" in this MD&A) being allowed to share the existing infrastructure with the Ovoot Tolgoi Mine; plans for the progress of mining license application processes; the possibility of the CIC Convertible Debenture and all accrued and unpaid interest becoming immediately due; future coal market conditions in China and the related impact on the Company's margins and liquidity; the outcome of the issues described under the heading "REGULATORY ISSUES AND CONTINGENCIES" in this MD&A; business outlook,

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

including the outlook for 2015; outlook for Mongolian coal exporters; whether coal prices in China will remain under pressure and whether that will continue to affect the Company; the completion of the share purchase transaction between Turquoise Hill Resources Ltd. ("Turquoise Hill") and National United Resources Holdings Limited ("NUR"); the completion of the sale and purchase agreement between Turquoise Hill and Novel Sunrise Investments Limited ("Novel Sunrise"); the closing of the Subsequent Tranche (as defined under the heading "MATERIAL CONTRACTS – Novel Private Placement" in this MD&A) of the private placement with Novel Sunrise; the implementation and impact of the Proposed Funding Plan (as defined under the heading "LIQUIDITY AND CAPITAL RESOURCES – Going Concern Considerations" in this MD&A) and actions to be taken under the Proposed Funding Plan; the outcome and results of the TSX's (as defined under the heading "OVERVIEW" in this MD&A) remedial delisting review of the Company; the Company continuing as a going concern and its ability to realized its assets and discharge its liabilities in the normal course of operations as they become due; adjustments to the amounts and classifications of assets and liabilities in the Company's financial statements and the impact thereof; the Company's objectives for 2015 and beyond, including plans regarding the 2015 exploration program; expected production at the Ovoot Tolgoi Mine; the possible impact of the review of the geology type at the Ovoot Tolgoi Mine and the as yet uncompleted revisions to Ovoot Tolgoi mine plan on quantities of measured and/or indicated resources and reserves of the Ovoot Tolgoi project; the impact of the completion of the paved highway; the expected date of commercial operation of the paved highway; the capacity of the paved highway being in excess of 20 million tonnes of coal per year; the impact of amendments to, or the application of the laws of Mongolia and other counties in which the Company carries on business; the expected time frame that the Company's workforce will be on furlough; the impact of the Company's activities on the environment and actions taken for the purpose of mitigation of potential environmental impacts; planned focus on health, safety and environmental performance; planned relationships with stakeholders; expansion of the Company's customer base; greenfield options with the Soumber Deposit and Zag Suuj Deposit (as defined under the heading "PROPERTIES – Development Projects and Exploration Program" in this MD&A); and other statements that are not historical facts. This list is not exhaustive of the factors that may affect any of the Company's forward-looking statements. Except as required by law, the Company undertakes no obligation to update forward-looking statements if circumstances or management's estimates or opinions should change. The reader is cautioned not to place undue reliance on forward-looking statements.

Table of Contents

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

Introduction

This Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") of SouthGobi Resources Ltd. (which, together with its subsidiaries, is collectively referred to as the "Company") should be read in conjunction with the consolidated financial statements of the Company and the notes thereto for the year ended December 31, 2014. The Company's consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board and Interpretations of the IFRS Interpretations Committee.

The functional currency of all of the Company's operations is the U.S. Dollar. All figures in this MD&A are presented in U.S. Dollars unless otherwise stated.

Disclosure of a scientific or technical nature in this MD&A, as derived from the technical report on the Ovoot Tolgoi Deposit dated March 19, 2012 (the "Ovoot Tolgoi Technical Report"), the technical report on the Soumber Deposit dated March 25, 2013 (the "Soumber Technical Report") and the technical report on the Zag Suuj Deposit dated March 25, 2013 (the "Zag Suuj Technical Report"), in respect of the Company's applicable material mineral projects was prepared by or under the supervision of the QPs listed below. Copies of the Ovoot Tolgoi Technical Report, the Soumber Technical Report and the Zag Suuj Technical Report are available on SEDAR at www.sedar.com.

Property	Qualified Persons	Field of Expertise	Relationship to Company
Ovoot Tolgoi	Merryl Peterson	Resources	Independent Consultant
Ovoot Tolgoi	Robert Mackenzie	Reserves	Independent Consultant
Ovoot Tolgoi	Ross Seedsman	Geotechnical	Independent Consultant
Ovoot Tolgoi	David Morris	Dry Coal Processing	Independent Consultant
Ovoot Tolgoi	Michael Evans	Wet Coal Processing	Independent Consultant
Soumber	Merryl Peterson	Resources	Independent Consultant
Zag Suuj	Merryl Peterson	Resources	Independent Consultant

Other disclosures of a scientific or technical nature in this MD&A in respect of the Ovoot Tolgoi Mine and the Soumber and Zag Suuj projects were prepared by employees of the Company and reviewed by Robert Mackenzie, an employee of RungePincockMinarco, a registered member and Chartered Professional (Mining) of the Australasian Institute of Mining and Metallurgy (Member No. 103878) and a Qualified Person, as that term is defined in NI 43-101. Robert Mackenzie was the Qualified Person responsible for overall preparation of and the coal reserve estimates in the Ovoot Tolgoi Technical Report.

1. Overview

The Company is an integrated coal mining, development and exploration company with 357 employees as at December 31, 2014. The Company'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. At December 31, 2014 Turquoise Hill Resources Ltd. ("Turquoise Hill") owned approximately 48% 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 project in Mongolia: the Ovoot Tolgoi open pit coal mine (the "Ovoot Tolgoi Mine") and the following significant development projects, the Ovoot Tolgoi Underground Deposit, the Soumber Deposit and the Zag Suuj 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 Company owns a 100% interest in these coal projects.

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. The Company commenced mining at the Ovoot Tolgoi Mine in 2008 and the Company sells coal at the mine-gate to Chinese customers. Ceke, at the Chinese side of the Shivee Khuren Border Crossing, is a major Chinese coal distribution terminal with rail connections to key coal markets in China.

1. Overview continued

Saleable products from the Ovoot Tolgoi Mine primarily include the SouthGobi standard ("Standard") and SouthGobi premium ("Premium") semi-soft coking coal products. Some higher-ash product is sold as a thermal coal product as and when the market allows.

Coal Reserves *(millions of tonnes)* (i)

Property	Proven	Probable	Total
Ovoot Tolgoi Mine (ii)	119	57	176

Coal Resources *(millions of tonnes)* (i)

Property	Measured	Indicated	Measured & Indicated	Inferred
Ovoot Tolgoi Mine (ii)	133	60	193	24
Ovoot Tolgoi Underground	66	43	109	62
Soumber Deposit	63	110	173	123
Zag Suuj Deposit	–	22	22	84
Total coal resources	262	235	497	293

(i) As at December 31, 2014. Reserves and resources estimates have been prepared in compliance with NI 43-101. The measured and indicated coal resources are inclusive of those coal resources modified to produce the coal reserves. Details of the assumptions and parameters used to estimate the reserves and resources and information on data verification are set out in the Annual Information Form dated March 30, 2014, and available on SEDAR at www.sedar.com.

(ii) Mine plan and geology for the Ovoot Tolgoi project are currently under review as discussed under the heading "Overview" of this MD&A below.

The Company is currently reviewing the geology and mine plan for Ovoot Tolgoi and changes thereto may impact the quantities of measured and/or indicated resources and reserves of Ovoot Tolgoi. The classification of the geology type of the coal deposits at the Ovoot Tolgoi Complex is currently under review. The results of this review are not yet known and may have a material impact on production levels from the Ovoot Tolgoi Complex. For more information on the risks associated with classification of geology type of coal deposits, refer to the Risk Factor entitled "The Company's coal reserves and resources are estimates based on a number of assumptions and the Company may produce less coal than its current estimates. See "Risk Factors – Reserves and Resources".

Significant Events and Highlights

The Company's significant events and highlights for the year ended December 31, 2014 and subsequent period to March 30, 2015 are as follows:

- The Company continues to operate under difficult market conditions resulting from strong seaborne and domestic supply coupled with soft demand in China. Chinese coking coal imports fell by 17.2% in 2014 and 12.6% in the fourth quarter of 2014 compared to the same periods last year. Coal prices in China stabilized in the fourth quarter of 2014, mainly due to winter restocking from end users, after hitting seven year lows in the third quarter. However, the gains made in the fourth quarter of 2014 have been erased since the beginning of 2015 due to sluggish demand, which has continued beyond the Chinese New Year holiday. The Company's sales volumes and revenues are expected to remain under pressure through 2015 as Chinese coal import volume and prices continue to decline.

- Production of raw coal by the Company remained low at 0.21 million tonnes in the fourth quarter of 2014 compared to 1.73 million tonnes in the fourth quarter of 2013. This lower production level is due to the Company's decision in June, in response to current market conditions, to reduce its production and place approximately half of its workforce on furlough. This furlough is anticipated to remain in place until market conditions improve.

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

1. Overview continued

Significant Events and Highlights continued

- On January 7, 2014, the Company reported the public announcement regarding the Ontario Action against certain of the Company's current and former senior officers and directors, and its former auditors, in relation to the Company's restatement of financial statements, as disclosed on November 8, 2013, November 11, 2013, November 14, 2013 and December 12, 2013.
- Messrs. Lindsay Dove and Sean Hinton did not stand for re-election at the Annual General Meeting held on May 6, 2014 and ceased to be directors at that date.
- On May 25, 2014, the Company announced that Turquoise Hill had agreed to provide a $10 million shareholder loan facility (the "Turquoise Hill Loan Facility").
- On June 20, 2014, the Company announced that the exemption granted to the Company in relation to its secondary listing status on the HKEX in 2010 by the Hong Kong Securities and Futures Commission pertaining to Takeovers, Mergers and Share Repurchases (the "Takeovers Code") had been withdrawn and that the Company would be considered a public company in Hong Kong for matters relating to the Takeovers Code.
- On July 30, 2014, the Company reported that Turquoise Hill had entered into a share purchase agreement ("SPA") with National Resources Holdings Limited ("NUR") to sell Common Shares representing 29.95% of the Company's total issued and outstanding Common Shares.
- On August 26, 2014, the Court of Justice in Mongolia returned the tax investigation case against the Company's subsidiary SouthGobi Sands LLC ("SGS") and three of its former employees to the Prosecutor General for further investigations.
- On August 31, 2014, the Company announced that Turquoise Hill had agreed to a limited deferral of repayment of all funds owing and due by the Company under the Turquoise Hill Loan Facility.
- On September 28, 2014, the Company announced the completion of the construction of a paved coal highway to the Shivee Khuren Border Crossing.
- On November 12, 2014, the Company announced the December 1, 2014, retirement of Ms. Kay Priestly as Chair, the appointment of current independent director Mr. Gordon Lancaster to the position of interim Chair and the appointment of Mr. Jeffery Tygesen as a non-executive director.
- On November 20, 2014, the Company announced that it was delaying the payment of the November 2014 installment of cash interest due to the China Investment Corporation ("CIC") under the terms of the Convertible Debenture (the "November CIC Payment").
- On December 1, 2014, the Company announced that it had entered into private placement and CIC had agreed to extend the cure period agreed for the November CIC Payment to December 4, 2014.
- On December 2, 2014, NUR signed an amendment agreement ("Amendment Agreement") to the previously announced and signed Sale and Purchase agreement dated July 29, 2014 with Turquoise Hill in respect of the sale of 56,102,000 Common Shares of the Company held by Turquoise Hill. In respect of the transaction contemplate, the Amendment Agreement provides, among other matters, for an extension to the closing date from November 30, 2014 to April 30, 2015.
- On December 3, 2014, the Company successfully completed private placements for the issue of 24,360,773 Common Shares for gross proceeds of US$9.0 million (US$8.9 million net after fees) at CAD $0.42 per share.

1. Overview continued

Significant Events and Highlights continued

- On December 4, 2014 Turquoise Hill agreed on a limited deferral of repayment on the $3.8 million principal owing under the Turquoise Hill Loan Facility. The Turquoise Hill Loan Facility matured on August 30, 2014 and is no longer available for further drawdowns by the Company. This limited deferral is subject to certain conditions and limitations, including the completion by April 30, 2015 of the transaction contemplated by the Sale and Purchase Agreement and the Amendment Agreement between Turquoise Hill and NUR.

- On December 12, 2014 the Company announced the stepping down of the President and Chief Executive Officer Ross Tromans, and appointment of Enkh-Amgalan Sengee as President and Chief Executive Officer. Mr. Tromans remained with the Company and on the Board of Directors (the "Board") until December 31, 2014.

- On December 30, 2014 the Company was notified that the Capital City Prosecutor (head of the Capital Prosecutor's Office, Ulaanbaatar, Mongolia) had decided to dismiss the allegations for money laundering against the Company's three former employees. This was consistent with the report issued by the experts appointed by the State Investigations Agency ("SIA") on June 30, 2013 and again in January 2014.

- In respect of the ongoing tax investigation case in Mongolia, on January 30, 2015 the panel of appointed judges from the Second District Criminal Court of Justice found the Company's three former employees guilty of tax evasion and gave sentences ranging from 5 years and 6 months to 5 years and 10 months of imprisonment in the correctional facilities of strict regimen in Mongolia. Although SGS was not a party to the criminal proceedings, the court declared it to be financial liable as a "civil defendant" for a penalty of MNT 35.3 billion (approximately US$18.2 million on February 1, 2015). The Company strongly believes it has not committed tax evasion, firmly rejects the Court's verdict and what have been gross violations of Mongolian law through the investigations and the Court process. Therefore the Company filed an appeal of the Second District Criminal Court of Justice's verdict on February 18, 2015. On February 26, 2015 the President of Mongolia issued a decree of pardon to the three former employees and following the pardon they were released from imprisonment and departed Mongolia. On March 25, 2015, the hearing of the appeal of the Tax Verdict took place. The Tax Verdict was upheld and the appeal by the Company was dismissed. It is the view of the Company that there is a lack of evidence to support both the Tax Verdict and the Appeal Verdict and, accordingly, the Company will continue to defend itself through all available legal means including a final appeal. The Tax Penalty would only be payable after a final appeal.

  For more information on the risks associated with the Tax Verdict, refer to the Risk Factor entitled "If the Company is unsuccessful in appealing the Tax Verdict it will likely not have sufficient cash resources to satisfy the penalty imposed thereunder." in this MD&A.

- On February 24, 2015 the Company announced it had entered into a private placement for proceeds of up to US$7.5 million with Novel Sunrise Investments Limited ("Novel Sunrise") as a proposed new significant investor and strategic partner. The completion of the private placement and related transactions was subject to acceptance of notice of the placement by the TSX pursuant to the financial hardship provisions of the TSX Company Manual. As a result of relying on the financial hardship provisions, the Company was placed on remedial delisting review as of February 25, 2015. A meeting of the TSX Continued Listing Committee to consider this matter has been scheduled for May 19, 2015.

- On February 24, 2015 the Company was advised by Turquoise Hill that they had entered into a Sale and Purchase Agreement ("Novel SPA") with Novel Sunrise for the purchase of 48,705,155 Common Shares currently held by Turquoise Hill. The closing of the Novel SPA is subject to certain terms and closing conditions.

1. Overview continued

Significant Events and Highlights continued

- On March 3, 2015 following the successful closing of the first tranche of the Novel Sunrise private placement, including the receipt of US$3.5 million, the Company issued 10,131,113 Mandatory Convertible Units to Novel Sunrise and in accordance with the terms of the agreement Mr. Ted Chan was appointed as the Executive Director of the Company.
- On March 13, 2015, Mr. Enkh-Amgalan Sengee, tendered his resignation as President and Chief Executive Officer. Mr. Ted Chan, assumed the duties formerly handled by Mr. Sengee until further notice.
- On March 18, 2015, the Company announced that Mr. Jeffery Tygesen resigned as a non-executive director.
- As at the date hereof, the Company, together with the new strategic partner, Novel Sunrise, has developed a funding plan in order to pay the interest due under the CIC Convertible Debenture, meet the Company's obligations as they fall due and achieve its business objectives in 2015 and beyond. However, there is no guarantee that the Company will be able to implement this funding plan or secure other sources of financing. See section 5 "Liquidity and Capital Resources" and section 11 "Risk Factors" for details. As at March 30, 2015, the Company had cash of $4.2 million.

2. Selected annual information

$ in thousands, except per share and per tonne information	Year ended December 31, 2014	2013	2012
Revenue (i)	**$ 24,494**	$ 58,636	$ 78,061
Loss from operations	**(82,734)**	(196,829)	(124,226)
Net loss	**(103,683)**	(237,464)	(97,502)
Basic loss per share	**$ (0.55)**	$ (1.30)	$ (0.54)
Diluted loss per share	**$ (0.55)**	$ (1.30)	$ (0.60)
Cash from/(used in) operating activities	**(29,673)**	7,559	(26,283)
Cash used in investing activities	**(625)**	(4,892)	(77,737)
Cash from/(used in) financing activities	**12,378**	129	(51)
Coal sales volumes *(millions of tonnes)* (ii)	**2.04**	3.26	1.98
Average realized selling price *(per tonne)* (iii)	**$ 14.76**	$ 24.25	$ 47.49

$ in thousands	As at December 31, 2014	2013	2012
Cash and cash equivalents	**$ 3,789**	$ 21,837	$ 19,674
Short term money market investments	**–**	–	15,000
Total cash and cash equivalents and money market investments	**3,789**	21,837	34,674
Total working capital	**3,430**	41,670	120,435
Total assets	**416,139**	506,206	732,452
Total non-current liabilities	**95,590**	96,610	103,771

(i) Revenue is presented after deduction of royalties and selling fees.

(ii) Coal sales volumes are from the Ovoot Tolgoi Mine.

(iii) Average realized selling price is presented before deduction of royalties and selling fees.

2. Selected annual information continued

In 2012, the Company's operations were impacted by transportation infrastructure constraints in Mongolia, the significant uncertainty resulting from certain regulatory issues facing the Company and the softening of Chinese coal markets. Mining activities at the Ovoot Tolgoi Mine were curtailed to varying degrees in the second quarter of 2012, with mining activities being fully curtailed at the end of the second quarter of 2012, to manage coal inventories and to maintain efficient working capital levels. Mining activities remained fully curtailed for the remainder of 2012. From 2012 to date, the Company has focused on minimizing uncommitted capital expenditures and exploration expenditures in order to preserve the Company's financial resources.

The Company resumed operations at the Ovoot Tolgoi Mine on March 22, 2013. The coal markets in China continued to be challenging in 2013 with certain coal price indices in China reaching four year lows during the year. In 2013, the Company generated $7.6 million of cash from operating activities following the resumption of mining activities at the Ovoot Tolgoi Mine.

Coal markets continued to deteriorate in 2014. Chinese coal markets, the main market of Mongolian producers, suffered from overcapacity coupled with decreasing demand. In the last quarter of 2014, the Company successfully completed a private placement for gross proceeds of $9.0 million.

3. Overview of operational data and financial results

Summary of Annual Operational Data

	Year ended December 31, 2014	2013
Sales Volumes, Prices and Costs		
Premium semi-soft coking coal		
Coal sales *(millions of tonnes)*	**0.02**	0.54
Average realized selling price *(per tonne)* (i)	**$ 26.77**	$ 36.61
Standard semi-soft coking coal		
Coal sales *(millions of tonnes)*	**0.86**	2.27
Average realized selling price *(per tonne)* (i)	**$ 19.52**	$ 23.41
Thermal coal		
Coal sales *(millions of tonnes)*	**1.16**	0.45
Average realized selling price *(per tonne)* (i)	**$ 10.99**	$ 13.43
Total		
Coal sales *(millions of tonnes)*	**2.04**	3.26
Average realized selling price *(per tonne)* (i)	**$ 14.76**	$ 24.25
Raw coal production *(millions of tonnes)*	**1.57**	3.06
Direct cash costs of product sold *(per tonne)* (ii)	**$ 8.28**	$ 10.58
Mine administration cash costs of product sold *(per tonne)* (ii)	**$ 2.69**	$ 2.23
Total cash costs of product sold *(per tonne)* (ii)	**$ 11.02**	$ 12.81
Other Operational Data		
Production waste material moved *(millions of bank cubic meters)*	**5.47**	8.45
Strip ratio *(bank cubic meters of waste material per tonne of coal produced)*	**3.51**	2.76
Lost time injury frequency rate (iii)	**0.21**	0.00

(i) Average realized selling price is presented before deduction of royalties and selling fees.

(ii) A non-IFRS financial measure, see section 4. Cash costs of product sold exclude idled mine asset cash costs.

(iii) Per 200,000 man hours and calculated based on a rolling 12 month average.

3. Overview of operational data and financial results continued

Overview of Annual Operational Data continued

The Company has operated under difficult market conditions throughout 2014 which have affected the Company's results in respect of sales prices, mix and volumes. In 2014, the Company sold 2.04 million tonnes of coal compared to 3.26 million in 2013.

The Company's production in 2014 was lower than 2013, at 1.57 million tonnes compared to 3.06 million tonnes. During 2014, the Company paced its production to market demand and focused on reducing its stockpiles. As a result the Company operated significantly below its operating capacity through-out 2014. Following a review of operations the Company placed approximately half of its workforce on furlough in mid June 2014 which is currently ongoing and is expected to last until market conditions improve. The results for 2013 were impacted by reduced operating levels as the operations at the Ovoot Tolgoi Mine recommenced on March 22, 2013 after a period of full curtailment since the end of the second quarter of 2012.

The Company maintained a strong safety record throughout 2014. As at December 31, 2014, the Company has a lost injury time frequency rate of 0.21 per 200,000 man hours based on a rolling 12 month average.

Summary of Annual Financial Results

$ in thousands, except per share information		Year ended December 31, 2014		2013
Revenue [(i),(ii)]	**$**	**24,494**	$	58,636
Cost of sales [(ii)]		**(82,132)**		(112,627)
Gross loss excluding idled mine asset costs		**(21,698)**		(23,552)
Gross loss including idled mine asset costs		**(57,638)**		(53,991)
Other operating expenses		**(14,840)**		(126,040)
Administration expenses		**(8,944)**		(15,629)
Evaluation and exploration expenses		**(1,312)**		(1,169)
Loss from operations		**(82,734)**		(196,829)
Finance costs		**(21,848)**		(21,162)
Finance income		**1,586**		5,566
Share of losses of joint venture		**(101)**		(53)
Income tax expense		**(586)**		(24,983)
Net loss		**(103,683)**		(237,464)
Basic loss per share	**$**	**(0.55)**	$	(1.30)
Diluted loss per share	**$**	**(0.55)**	$	(1.30)

(i) Revenue is presented after deduction of royalties and selling fees.

(ii) Revenue and cost of sales relate to the Company's Ovoot Tolgoi Mine within the Mongolian Coal Division operating segment. Refer to note 4 of the consolidated financial statements for further analysis regarding the Company's reportable operating segments.

Royalty regime in Mongolia

The royalty regime in Mongolia is evolving and has been subject to change since 2012. The Government of Mongolia implemented a trial period from October 1, 2012 to March 31, 2013, during which the royalty imposed on coal sales was determined using the actual contracted sales price per tonne. Subsequently, from April 1, 2013 to March 31, 2014, the royalty on all coal sales exported out of Mongolia was based on a set reference price per tonne published monthly by the Government of Mongolia.

3. Overview of operational data and financial results continued

Royalty regime in Mongolia continued

The Government of Mongolia implemented a new royalty regime effective April 1, 2014, referred to as the "flexible tariff" royalty regime. From April 1, 2014, the royalty per tonne for export coal sales has been calculated based on the actual contracted sales price per tonne, whereby the contracted sales price includes the costs of transporting the coal to the Mongolia-China border. If transportation costs are not included in the contracted sales price between a buyer and seller, the following costs are required to be included in the contracted sales price for purposes of calculating the royalty per tonne: transportation costs and costs associated with transportation such as customs documentation fees, insurance, loading and unloading costs. In the event the actual contracted sales price calculated as described above differs by more than 10% from the contracted sales price of coal products with the same classification and quality being exported by other legal entities in Mongolia through the same border crossing, the calculated contracted sales price is deemed non-market under Mongolian tax law and the royalty per tonne is calculated based on a reference price that will be determined by the Government of Mongolia.

The Company currently sells coal from the Ovoot Tolgoi Mine ex mine gate and the coal is exported through the Shivee Khuren Border Crossing. The Company's average realized selling price excludes transportation costs.

On July 4, 2014, the Government of Mongolia made further amendments to the royalty regime. From July 4, 2014 onwards, the royalty is to be initially calculated and paid monthly based on the Government reference price. On a quarterly basis the royalty amount is to be adjusted to reflect the contracted sales price and additional documentation needs to be submitted to the Mongolian Tax Authority. Once the quarterly statement has been approved by the Mongolian Tax Authority, any adjustments between the monthly payments for the quarter and the quarterly submission are adjusted in the next months' royalty calculation.

On January 1 2015, this "flexible tariff" royalty regime ended and royalty payments have reverted to the previous regime which is based on a set reference price per tonne published monthly by the Government of Mongolia. The Company and other Mongolian coal producers are actively engaging the Mongolian authorities to seek the continuation of the "flexible tariff" regime. See "Risk Factors – Company's Projects in Mongolia".

Overview of Annual Financial Results

The Company recorded an $82.7 million loss from operations in 2014 compared to a $196.8 million loss from operations in 2013. The 2014 operations were impacted by continuing difficult market conditions which resulted in lower sales volumes and prices compared to 2013. This reduction in prices was offset by lower royalty expenses, lower administration expenses and lower impairment losses in 2014.

Revenue was $24.5 million in 2014 compared to $58.6 million in 2013. The Company sold 2.04 million tonnes of coal at an average realized selling price of $14.76 per tonne in 2014 compared to sales of 3.26 million tonnes at an average realized selling price of $24.25 per tonne in 2013. The reduction in the average realized selling price resulted from continuous difficult market conditions as well as differences in product mix in 2014 compared to 2013. The product mix in 2014 consisted of approximately 43% of Standard semi-soft coking coal with minimal sales of Premium semi-soft coking coal compared to approximately 86% of sales consisting of either Premium or Standard semi-soft coking coal in 2013.

The Company's revenue is presented after deduction of royalties and selling fees. Following the change in the royalty regime in Mongolia on April 1, 2014, the Company's effective royalty rate for 2014, based on the Company's average realized selling price of $14.76 per tonne, was 12.5% or $1.85 per tonne compared to 19.1% or $4.53 per tonne based on the average realized selling price of $24.25 per tonne in 2013.

3. Overview of operational data and financial results continued

Overview of Annual Financial Results continued

Cost of sales was $82.1 million in 2014 compared to $112.6 million in 2013. Cost of sales comprises operating expenses, share-based compensation expense, equipment depreciation, depletion of mineral properties, coal stockpile inventory impairments and idled mine asset costs. Operating expenses in cost of sales reflect the total cash costs of product sold (a non-IFRS financial measure, see section 4 for further analysis) during the period.

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

Operating expenses in cost of sales were $22.5 million in 2014 compared to $41.7 million in 2013. The overall decrease in operating expenses is the result of both (i) the lower variable costs which are linked to production levels which are down to 1.57 million tonnes in 2014 compared to 3.06 million tonnes in 2013; and (ii) the continued focus on cost saving initiatives, including the furlough which commenced in mid-June 2014. The total cash cost of product sold decreased from $12.81 per tonne in 2013 to $11.02 per tonne in 2014.

Cost of sales in 2014 and 2013 included coal stockpile impairments of $16.3 million and $20.7 million, respectively, to reduce the carrying value of the Company's coal stockpiles to their net realizable value. The coal stockpile impairments recorded in both 2014 and 2013 reflect the challenging coal market conditions and primarily related to the Company's higher-ash products.

Cost of sales related to idled mine asset costs primarily consisted of period costs, which were expensed as incurred and included mainly depreciation expense. Cost of sales related to idled mine assets in 2014 included $30.3 million related to depreciation expenses for idled equipment (2013: $25.1 million).

Other operating expenses were $14.8 million in 2014 compared to $126.0 million in 2013.

$ in thousands	Year ended December 31, 2014	2013
Public infrastructure	**$ –**	$ 7
Sustainability and community relations	**253**	235
Foreign exchange loss/(gain)	**(1,151)**	1,659
Provision for doubtful trade and other receivables	**567**	200
Impairment loss on available-for-sale financial asset	**1,766**	3,067
Loss on disposal of property, plant and equipment	**–**	895
Impairment of property, plant and equipment	**8,879**	72,669
Impairment of prepaid expenses and deposits	**3,780**	30,152
Impairment of materials and supplies inventories	**2,981**	14,962
Gain on disposal of mining licenses	**(2,235)**	–
Other	**–**	2,194
Other operating expenses	**$ 14,840**	$ 126,040

Compared to 2013, the decrease in other operating expenses is primarily related to lower impairment charges in 2014.

3. Overview of operational data and financial results continued

Overview of Annual Financial Results continued

The Company recognized an impairment loss of $1.8 million in 2014 related to its investment in Aspire compared to an impairment loss of $3.1 million in 2013. The Company's investment in Aspire is accounted for as an available-for-sale financial asset and carried at its fair value. The Company disposed all its investment in Aspire during 2014 and did not hold any Aspire shares as at December 31, 2014.

In 2014, the Company recognized an impairment loss of $3.4 million related to prepaid toll washing fees under the Ejin Jinda contract. The impairment charge, which was recorded in the second quarter of 2014, was a result of the continued delay in starting the commercial operations at the wet washing facility and the continued soft coal market in China. The Company also recognized in 2014 an impairment charge of $3.0 million in respect of surplus materials and supplies inventories as the Company continued to operate below capacity in 2014. In comparison, in 2013, the Company recognized a total of $15.0 million in impairment in respect of material and supplies inventory.

Given the difficult market conditions and the associated delays in projects and the commissioning of equipment, the Company recorded $8.9 million of impairment charges to reduce various items of property, plant and equipment to their recoverable amounts for the year ended December 31, 2014 (2013: $72.7 million).

A gain of $2.2 million was recorded from the disposal of mining licenses in 2014. In the second quarter of 2014, $1.8 million was recorded after the Company completed the sale of the Tsagaan Tolgoi mining license. A further $0.4 million was recorded in the fourth quarter of 2014 after the partial sale of exploration license 9449X.

Administration expenses were $8.9 million in 2014 compared to $15.6 million in 2013.

$ in thousands		Year ended December 31, 2014		2013
Corporate administration	**$**	**2,591**	$	3,269
Legal and professional fees		**2,680**		8,252
Salaries and benefits		**2,955**		3,748
Share-based compensation expense		**590**		167
Depreciation		**128**		193
Administration expenses	**$**	**8,944**	$	15,629

Administration expenses were lower in 2014 compared to 2013 primarily due to lower professional fees during the year. Professional fees in 2013 included $4.3 million of fees related to the internal investigations led by a tripartite committee referred to in section 6 "Regulatory Issues and Contingencies". The tripartite committee substantially completed the investigative phase of its activities during 2013; therefore no substantial additional professional fees incurred in 2014.

Corporate administration costs were also lower in 2014 compared to 2013 reflecting the Company's cost reduction initiatives.

Evaluation and exploration expenses $1.3 million in 2014 compared to $1.2 million in 2013. The Company continued to minimize evaluation and exploration expenditures in 2014 in order to preserve the Company's financial resources. Evaluation and exploration activities and expenditures in 2014 were limited to ensuring that the Company met the Mongolian Minerals Law requirements in respect of its mining and exploration licenses.

Finance costs were $21.8 million and $21.2 million in 2014 and 2013 respectively which primarily consisted of interest expense on the $250.0 million CIC Convertible Debenture.

3. Overview of operational data and financial results continued

Overview of Annual Financial Results continued

Finance income was $1.6 million in 2014 compared to $5.6 million in 2013 primarily relating to unrealized gains on the change in fair value of the embedded derivatives in the CIC Convertible Debenture ($1.6 million and $5.5 million respectively for 2014 and 2013). The fair value of the embedded derivatives in the CIC Convertible Debenture is driven by many factors including: the Company's common share price, U.S. Dollar and Canadian Dollar exchange rates and share price volatility.

Income tax expense was $0.6 million in 2014 compared to an expense of $25.0 million in 2013. In 2014 $0.5 million relates to taxes paid in respect of the sale of the Tsagaan Tolgoi mining license. The $25.0 million expense for 2013 related to deductible temporary differences and adjustments to the amount of loss carry-forwards recognized. No corresponding amounts in respect of deferred tax balances were recorded in 2014.

Summary of Quarterly Operational Data

	2014				2013			
Quarter Ended	**31-Dec**	**30-Sep**	**30-Jun**	**31-Mar**	31-Dec	30-Sep	30-Jun	31-Mar
Sales Volumes, Prices and Costs								
Premium semi-soft coking coal								
Coal sales *(millions of tonnes)*	**0.02**	**–**	**–**	**–**	0.21	0.04	0.21	0.08
Average realized selling price *(per tonne)* (i)	**$ 26.77**	**$ –**	**$ –**	**$ –**	$ 37.54	$ 37.50	$ 32.46	$ 45.81
Standard semi-soft coking coal								
Coal sales *(millions of tonnes)*	**0.14**	**0.31**	**0.12**	**0.29**	1.40	0.87	–	–
Average realized selling price *(per tonne)* (i)	**$ 18.32**	**$ 17.41**	**$ 20.33**	**$ 22.00**	$ 24.49	$ 21.67	$ –	$ –
Thermal coal								
Coal sales *(millions of tonnes)*	**0.21**	**0.34**	**0.51**	**0.10**	0.11	0.03	0.11	0.20
Average realized selling price *(per tonne)* (i)	**$ 11.69**	**$ 10.66**	**$ 10.72**	**$ 12.07**	$ 12.60	$ 13.07	$ 13.98	$ 13.67
Total								
Coal sales *(millions of tonnes)*	**0.37**	**0.65**	**0.63**	**0.39**	1.72	0.94	0.32	0.28
Average realized selling price *(per tonne)* (i)	**$ 15.04**	**$ 13.87**	**$ 12.52**	**$ 19.54**	$ 25.30	$ 22.05	$ 26.26	$ 22.75
Raw coal production *(millions of tonnes)*	**0.21**	**0.17**	**0.55**	**0.64**	1.73	1.13	0.17	0.02
Direct cash costs of product sold *(per tonne)* (ii)	**$ 8.09**	**$ 7.38**	**$ 8.23**	**$ 10.43**	$ 11.13	$ 9.41	$ 11.49	$ 10.22
Mine administration cash costs of product sold *(per tonne)* (ii)	**$ 2.44**	**$ 2.30**	**$ 2.49**	**$ 3.80**	$ 1.39	$ 2.20	$ 7.14	$ 1.46
Total cash costs of product sold *(per tonne)* (ii)	**$ 10.53**	**$ 9.68**	**$ 10.72**	**$ 14.23**	$ 12.52	$ 11.61	$ 18.63	$ 11.68
Other Operational Data								
Production waste material moved *(millions of bank cubic meters)*	**0.55**	**0.20**	**2.17**	**2.55**	3.77	1.57	2.71	0.40
Strip ratio *(bank cubic meters of waste material per tonne of coal produced)*	**2.61**	**1.20**	**3.97**	**4.02**	2.18	1.39	15.55	26.21
Lost time injury frequency rate (iii)	**0.21**	**0.17**	**0.15**	**0.00**	0.00	0.00	0.00	0.00

(i) Average realized selling price is presented before deduction of royalties and selling fees.

(ii) A non-IFRS financial measure, see section 4. Cash costs of product sold exclude idled mine asset cash costs.

(iii) Per 200,000 man hours and calculated based on a rolling 12 month average.

3. Overview of operational data and financial results continued

Overview of Quarterly Operational Data continued

Due to difficult market conditions, the Company has paced production with demand for its coal products. Although a seasonally strong period, the fourth quarter of 2014 remained anemic with only a modest increase in coal prices. As a result, the Company operated significantly below capacity during the quarter and its production increased only slightly from 0.17 million tonnes in the third quarter of 2014 to 0.21 million tonnes in the fourth quarter of 2014. Since mid-June 2014 following a review of operations, the Company further reduced its production and placed approximately half of its workforce on furlough. This furlough is expected to continue until market conditions improve for the Company.

The Company maintained a strong safety record and completed the fourth quarter of 2014 without a lost time injury. As at December 31, 2014, the Company has a lost injury time frequency rate of 0.21 per 200,000 man hours based on a rolling 12 month average while the Company ended 2013 without a lost time injury.

Summary of Quarterly Financial Results

$ in thousands, except per share information	2014				2013			
Quarter Ended	**31-Dec**	**30-Sep**	**30-Jun**	**31-Mar**	31-Dec	30-Sep	30-Jun	31-Mar
Financial Results								
Revenue (i), (ii)	**$ 5,054**	**$ 7,611**	**$ 6,691**	**$ 5,137**	$ 32,457	$ 15,652	$ 6,129	$ 4,398
Cost of sales (ii)	**(19,757)**	**(23,922)**	**(20,086)**	**(18,366)**	(40,359)	(33,486)	(17,477)	(21,305)
Gross loss excluding idled mine asset costs	**(821)**	**(2,178)**	**(8,497)**	**(10,202)**	(4,141)	(13,323)	(5,593)	(494)
Gross loss including idled mine asset costs	**(14,703)**	**(16,311)**	**(13,395)**	**(13,229)**	(7,900)	(17,834)	(11,348)	(16,907)
Other operating expenses	**(11,989)**	**(2)**	**(1,776)**	**(1,073)**	(109,682)	(1,003)	(14,925)	(431)
Administration expenses	**(1,924)**	**(2,530)**	**(2,253)**	**(2,237)**	(3,668)	(4,204)	(4,024)	(3,733)
Evaluation and exploration expenses	**(911)**	**(122)**	**(107)**	**(172)**	(489)	(186)	(221)	(273)
Loss from operations	**(29,527)**	**(18,965)**	**(17,531)**	**(16,711)**	(121,740)	(23,227)	(30,518)	(21,344)
Finance costs	**(6,351)**	**(5,257)**	**(5,215)**	**(5,025)**	(5,167)	(5,382)	(5,617)	(4,996)
Finance income	**317**	**135**	**127**	**1,007**	1,301	124	3,366	775
Share of earnings/(losses) of joint venture	**(40)**	**(32)**	**(3)**	**(26)**	(15)	(66)	44	(17)
Income tax recovery/(expense)	**(40)**	**–**	**(546)**	**–**	(13,109)	(13,377)	(416)	1,916
Net loss	**(35,641)**	**(24,119)**	**(23,168)**	**(20,755)**	(138,730)	(41,928)	(33,141)	23,666)
Basic loss per share	**$ (0.19)**	**$ (0.13)**	**$ (0.12)**	**$ (0.11)**	$ (0.75)	$ (0.23)	$ (0.18)	$ (0.13)
Diluted loss per share	**$ (0.19)**	**$ (0.13)**	**$ (0.12)**	**$ (0.11)**	$ (0.75)	$ (0.23)	$ (0.18)	$ (0.13)

(i) Revenue is presented after deduction of royalties and selling fees.

(ii) Revenue and cost of sales relate to the Company's Ovoot Tolgoi Mine within the Mongolian Coal Division operating segment. Refer to note 4 of the consolidated financial statements for further analysis regarding the Company's reportable operating segments.

Overview of Quarterly Financial Results

The Company recorded a $29.5 million loss from operations in the fourth quarter of 2014 compared to a $121.7 million loss from operations in the fourth quarter of 2013. Continuing difficult market conditions resulted in lower sales prices and volumes in the fourth quarter of 2014 compared to the fourth quarter of 2013. This reduction in prices and volumes was offset by a lower royalty rate, lower administration expenses and lower impairment charges in the fourth quarter of 2014 compared to the fourth quarter of 2013.

3. Overview of operational data and financial results continued

Overview of Quarterly Financial Results continued

Revenue was $5.1 million in the fourth quarter of 2014 compared to $32.5 million in the fourth quarter of 2013. The Company sold 0.37 million tonnes of coal at an average realized selling price of $15.04 per tonne in the fourth quarter of 2014 compared to sales of 1.72 million tonnes at an average realized selling price of $25.30 per tonne in the fourth quarter of 2013. Revenue decreased in the fourth quarter of 2014 compared to the fourth quarter of 2013 as a result of the combination of lower sales volumes and lower sales prices. The average realized selling price in the fourth quarter of 2014 compared to the fourth quarter of 2013 was also impacted by differences in product mix. The majority of the Company's sales in the fourth quarter of 2014 were of Thermal coal product while Standard semi-soft coking coal comprised the majority of sales in the fourth quarter of 2013.

The Company's revenue is presented after deduction of royalties and selling fees. Following the change in the Mongolia's royalty regime starting April 1, 2014, the Company's effective royalty rate for the fourth quarter of 2014, based on the Company's average realized selling price of $15.04 per tonne, was 8.1% or $1.22 per tonne. In the fourth quarter of 2013, the Company was subject to an average 7% royalty based on a weighted average reference price of $69.17 per tonne. As a result, the Company's effective royalty rate was 19.1% or $4.84 per tonne based on the average realized selling price of $25.30 per tonne in the fourth quarter of 2013.

Cost of sales was $19.8 million in the fourth quarter of 2014 compared to $40.4 million in the fourth quarter of 2013. Cost of sales comprises operating expenses, share-based compensation expense, equipment depreciation, depletion of mineral properties, coal stockpile inventory impairments and idled mine asset costs. Operating expenses in cost of sales reflect the total cash costs of product sold (a non-IFRS financial measure, see section 4 for further analysis) during the period.

	Three months ended December 31,	
$ in thousands	**2014**	2013
Operating expenses	**$ 3,895**	$ 21,537
Share-based compensation expense	**(3)**	28
Depreciation and depletion	**953**	10,096
Impairment of coal stockpile inventories	**1,030**	4,938
Cost of sales from mine operations	**5,875**	36,599
Cost of sales related to idled mine assets	**13,882**	3,760
Cost of sales	**$ 19,757**	$ 40,359

Operating expenses included in cost of sales were $3.9 million in the fourth quarter of 2014 compared to $21.5 million in the fourth quarter of 2013. The overall decrease in operating expenses is the result of the lower variable costs which are linked to production levels which are down to 0.21 million tonnes in the fourth quarter of 2014 compared to 1.73 million tonnes in the fourth quarter of 2013 and the continued focus on cost saving initiatives, including the furlough which commenced in mid-June 2014. The total cash cost of product sold decreased from $12.52 per tonne in the fourth quarter of 2013 to $10.53 per tonne in the fourth quarter of 2014.

Cost of sales in the fourth quarter of 2014 and the fourth quarter of 2013 included coal stockpile impairments of $1.0 million and $4.9 million, respectively, to reduce the carrying value of the Company's coal stockpiles to their net realizable value. The coal stockpile impairments recorded in both 2014 and 2013 reflect the challenging coal market conditions and primarily related to the Company's higher-ash products.

Idled mine asset costs included in cost of sales increased in the fourth quarter of 2014 compared to the fourth quarter of 2013 as a result of the mining operations' slowdown which commenced in June 2014. Idled mine asset costs in the fourth quarter of 2014 included $11.6 million related to depreciation expense for idled mine equipment (2013: $3.7 million).

3. Overview of operational data and financial results continued

Overview of Quarterly Financial Results continued

Other operating expenses were $12.0 million in the fourth quarter of 2014 (2013: $109.7 million).

$ in thousands	Three months ended December 31, 2014	2013
Public infrastructure	$ –	$ 1
Sustainability and community relations	42	117
Foreign exchange loss/(gain)	(163)	631
Provision for doubtful trade and other receivables	567	200
Impairment of property, plant and equipment	8,603	68,370
Impairment of prepaid expenses and deposits	375	30,152
Impairment of materials and supplies inventories	2,981	8,032
Gain on disposal of mining license	(416)	–
Other	–	2,179
Other operating expenses	$ 11,989	$ 109,682

The Company's other operating expenses were significantly lower in the fourth quarter of 2014 compared to the fourth quarter of 2013 primarily due to reduced impairment charges totaling $12.0 million in the fourth quarter of 2014 compared to $106.6 million in the fourth quarter of 2013.

Given the difficult market condition and delay in commissioning of the equipment, the Company recorded $8.6 million of impairment charges to reduce various items of property, plant and equipment to their recoverable amounts in the fourth quarter of 2014.

The Company recorded $68.4 million of impairment charges in the fourth quarter of 2013 to reduce various items of PP&E to their recoverable amounts. The impairment charges in 2013 included $66.4 million related to the dry coal handling facility ("DCHF") (refer to section 5 "Processing Infrastructure – Dry Coal Processing" for further analysis).

An impairment of prepaid expenses and deposit of $30.2 million was included in other operating expenses in the fourth quarter of 2013 related to prepaid toll washing fees under the Ejin Jinda contract (refer to section 5 "Processing Infrastructure – Wet Washing Facility" for further analysis of the impairment charge).

Furthermore, following the results of a review of the Company's mining fleet in the fourth quarter of 2013, $7.5 million of additional surplus materials and supplies inventories were identified. A corresponding review performed in the fourth quarter of 2014 with an impairment charge of $3.0 million identified as the Company continued to operate below capacity. The impairment charge in the fourth quarter of 2013 also included $0.5 million of materials and supplies related to the DCHF for which there was no corresponding impairment in the fourth quarter of 2014.

Administration expenses were $1.9 million in the fourth quarter of 2014 compared to $3.7 million in the fourth quarter of 2013.

$ in thousands	Three months ended December 31, 2014	2013
Corporate administration	$ 865	$ 1,052
Legal and professional fees	243	2,075
Salaries and benefits	774	780
Share-based compensation expense	10	(275)
Depreciation	32	36
Administration expenses	$ 1,924	$ 3,668

3. Overview of operational data and financial results continued

Overview of Quarterly Financial Results continued

Administration expenses decreased in the fourth quarter of 2014 compared to the fourth quarter of 2013 due to lower professional fees and overhead cost reduction initiatives. Legal and professional fees in the fourth quarter of 2013 included $1.8 million of fees related to the internal investigations led by a tripartite committee referred to in section 6 "Regulatory Issues and Contingencies". The tripartite committee substantially completed the investigative phase of its activities during 2013. Therefore, additional professional fees were not incurred in the fourth quarter of 2014.

Evaluation and exploration expenses were $0.9 million in the fourth quarter of 2014 compared to $0.5 million in the fourth quarter of 2013. The Company continued to minimize evaluation and exploration expenditures in the fourth quarter of 2014 in order to preserve the Company's financial resources. Evaluation and exploration activities and expenditures in the fourth quarter of 2014 were limited to ensuring that the Company met the Mongolian Minerals Law requirements in respect of its mining and exploration licenses.

Finance costs were $6.4 million and $5.2 million in the fourth quarters of 2014 and 2013 which primarily consisted of interest expense on the $250.0 million CIC Convertible Debenture. Further, $1.1 million of realized loss was recorded in relations to the disposal of Aspire shares in the fourth quarter of 2014.

Finance income was $0.3 million in the fourth quarter of 2014 compared to $1.3 million in the fourth quarter of 2013 and primarily consisting of unrealized gains on the fair value change of the embedded derivatives in the CIC Convertible Debenture ($0.3 million in the fourth quarter of 2014 and $1.6 million in the fourth quarter of 2013). The fair value of the embedded derivatives in the CIC Convertible Debenture is driven by many factors including: the Company's common share price, U.S. Dollar and Canadian Dollar exchange rates and share price volatility.

Income tax expense was nil in the fourth quarter of 2014 compared to an expense of $13.1 million in the fourth quarter of 2013. The $13.1 million expense in the fourth quarter of 2013 related to deductible temporary differences and adjustments to the amount of loss carry-forwards being recognized. No corresponding amounts in respect of deferred tax balances were recorded in the fourth quarter of 2014.

4. Non-IFRS financial measures

The Company has included the non-IFRS financial measure "cash costs" in this MD&A to supplement its condensed consolidated interim financial statements, which have been prepared in accordance with IFRS.

The Company believes that this measure, 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 measure is intended to provide additional information and should not be considered in isolation or as substitute for measures of performances prepared in accordance with IFRS.

Cash Costs

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

4. Non-IFRS financial measures continued

Cash Costs continued

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 coal stockpile inventory turnover and impairments of coal stockpile inventories from prior periods.

$ in thousands, except per tonne information	Three months ended December 31, **2014**	2013	Year ended December 31, **2014**	2013
Cash costs				
Cost of sales determined in accordance with IFRS	**$ 19,757**	$ 40,359	**$ 82,132**	$ 112,627
Less non-cash expenses	**(1,980)**	(15,062)	**(23,721)**	(40,442)
Less non-cash idled mine asset costs	**(11,564)**	(3,721)	**(30,305)**	(25,053)
Total cash costs	**6,213**	21,576	**28,106**	47,132
Less idled mine asset cash costs	**(2,318)**	(39)	**(5,634)**	(5,386)
Total cash costs excluding idled mine asset cash costs	**3,895**	21,537	**22,472**	41,746
Coal sales *(millions of tonnes)*	**0.37**	1.72	**2.04**	3.26
Total cash costs of product sold *(per tonne)*	**$ 10.53**	$ 12.52	**$ 11.02**	$ 12.81

$ in thousands, except per tonne information	Three months ended December 31, **2014**	2013	Year ended December 31, **2014**	2013
Cash costs				
Direct cash costs of product sold *(per tonne)*	**$ 8.09**	$ 11.13	**$ 8.33**	$ 10.58
Mine administration cash costs of product sold *(per tonne)*	**2.44**	1.39	**2.69**	2.23
Total cash costs of product sold *(per tonne)*	**$ 10.53**	$ 12.52	**$ 11.02**	$ 12.81

5. Properties

The Company currently holds two mining licenses and four exploration licenses in Mongolia, which in total cover an area of approximately 223,000 hectares ("ha"). The mining licenses pertain to the Ovoot Tolgoi Complex (12726A) and the Soumber Deposit (MV-016869).

In addition to the existing mining licenses, the Company also holds two exploration licenses (9443X and 9449X) pertaining to certain areas associated with the Soumber Deposit for which pre-mining agreements ("PMAs") have been issued. The Company holds two mineral exploration licenses (license numbers 13779X and 5267X) pertaining to the Zag Suuj Deposit for which PMAs have been issued.

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, 320km southwest of the provincial capital of Dalanzadgad and 950km southwest of the nation's capital of Ulaanbaatar. 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.

5. Properties continued

Operating Mines continued

Ovoot Tolgoi Mine continued

Saleable products from the Ovoot Tolgoi Mine primarily include the Standard and Premium semi-soft coking coal products. The Company's raw semi-soft products together with raw higher-ash coals are suitable for washing and blending in order to be sold as a 1/3 coking coal in the Chinese market. Some higher-ash product is sold as a thermal coal product as and when the market allows. The Company intends to continue to develop markets for both its Premium and Standard semi-soft coking coal brands and to pursue long-term supply offtake with end users in China to complement its existing customer base and to gain best value of the Company's coal in the Chinese market. The Company is committed to further enhancing the quality of its coal products through wet washing and increasing its market penetration in China, and as part of this strategy is cooperating with Ejin Jinda to study the utilization of the Ejin Jinda wet washing facility (refer to "Processing Infrastructure – Wet Washing Facility" section below).

Reserves and Resources

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 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 Measured and Indicated Mineral Resources are inclusive of those Mineral Resources modified to produce the Mineral Reserves. Details of the assumptions and parameters used to estimate the reserves, resources and coal quality estimates and information on data verification are set out in the company's Annual Information Form dated March 30, 2015, and available on SEDAR at www.sedar.com (the "Annual Information Form").

The Company is currently reviewing the geology and mine plan for Ovoot Tolgoi and changes thereto may impact the quantities of measured and/or indicated resources and reserves of Ovoot Tolgoi. The classification of the geology type of the coal deposits at the Ovoot Tolgoi Complex is currently under review. The results of this review are not yet known and may have a material impact on production levels from the Ovoot Tolgoi Complex. For more information on the risks associated with classification of geology type of coal deposits, refer to the Risk Factor entitled "The Company's coal reserves and resources are estimates based on a number of assumptions and the Company may produce less coal than its current estimates.

The coal 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.

Operational Data and Financial Results

Refer to section 3 for an overview of the operational data and financial results of the Ovoot Tolgoi Mine.

Processing Infrastructure

Dry Coal Processing

Following an extensive review that commenced in the fourth quarter of 2013, the Company concluded that it did not plan to either complete or use the DCHF at the Ovoot Tolgoi Mine in the foreseeable future. As a result of the review and subsequent impairment assessment, the Company recorded a $66.9 million non-cash impairment charge in the fourth quarter of 2013 to reduce the carrying value of the DCHF to its recoverable amount. The DCHF had a carrying value of $11.2 million at December 31, 2014. The Company continues to use mobile screens for initial dry processing of its higher-ash coals. The use of mobile screens at stockpile areas closer to the pits has enabled the Company to realize a cost benefit compared to hauling the coal to the central DCHF and operating the rotary breaker. This provides a lower cost solution without adversely impacting the coal quality of the coal planned to be mined over the next year.

When coal markets improve and production from the Ovoot Tolgoi Mine increases in line with its anticipated annual capacity of 9 million tonnes run-of-mine production, the Company will review the use of the DCHF as part of its existing assets and continue developing beneficiation capabilities to maximize value from its product.

5. Properties continued

Operating Mines continued

Processing Infrastructure continued

Wet Washing Facility

In 2011, the Company entered into an agreement with Ejin Jinda, a subsidiary of China Mongolia Coal Co. Ltd. to toll-wash coals from the Ovoot Tolgoi Mine. The agreement has a duration of five years from commencement of the contract and provides for an annual wet washing capacity of approximately 3.5 million tonnes of input coal. To date, commercial operations at the wet washing facility have not commenced.

In 2011, the Company made an initial payment of $33.6 million in respect of prepaid toll washing fees. The Company recorded a $30.2 million impairment loss on the $33.6 million of prepaid toll washing fees during the year ended December 31, 2013 and in the quarter ended June 30, 2014, the Company recorded an additional impairment of $3.4 million to fully impair the deposit. As at December 31, 2014 the Company has reassessed the carrying value of this prepayment and continues to believe it is appropriate for the balance to be fully impaired. This impairment continues to be recognized due to the continued delay in starting the commercial operations at the wet washing facility and the continued soft coal market in China.

Under the original agreement which required the commercial operation of the wet washing facility to commence on October 1, 2011 the additional fees payable by the Company under wet washing contract would be $18.5 million. The Company assesses on a continuous basis the agreement with Ejin Jinda and has determined it is not probable the $18.5 million will be required to be paid as part of the initial contract.

The Company's objective continues to be the implementation of an effective and profitable wet washing solution, and the Company is cooperating with Ejin Jinda in reviewing the utilization of the wet washing facility.

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 SGS (together referred to as "RDCC LLC"). SGS holds a 40% interest in RDCC LLC.

On October 26, 2011, RDCC LLC signed a concession agreement with the State Property Committee of Mongolia. RDCC LLC has the right to conclude a 17 year build, operate and transfer agreement under the Mongolian Law on Concessions. The Company announced the completion of the paved highway construction on September 28, 2014. The completion of the highway was one of the Company's key objectives for 2014 and will significantly increase the safety of coal transportation, reduce environmental impacts and improve the efficiency and capacity of coal transportation. The highway was commissioned in January 2015.

On September 27, 2014 a traffic opening ceremony was held in respect of a new paved highway from the Ovoot Tolgoi Complex to the Shivee Khurne Border Crossing. This highway which the Company has an indirect 40% shareholding is expected to significantly increase the safety of coal transportation, reduce environmental impacts and improve efficiency and capacity of coal transportation. The commercial operation of this highway has been delayed and is currently expected to commence in the second quarter of 2015. The paved highway is expected to have a carrying capacity in excess of 20 million tonnes of coal per year.

Mining Equipment

The key elements of the currently commissioned mining fleet includes: two Liebherr 996 ($33m^3$ & $36m^3$) hydraulic excavators, three Liebherr R9250 ($15m^3$) hydraulic excavators, 22 MT4400AC (218 tonne capacity) haul trucks and two Terex TR100 (91 tonne capacity) haul trucks, together with various pieces of ancillary equipment. The 2014 production plan did not fully utilize the Company's existing mining fleet.

5. Properties continued

Operating Mines continued

Workforce

As at December 31, 2014, SouthGobi Sands LLC employed 349 employees in Mongolia. Of the 349 employees, 39 are employed in the Ulaanbaatar office, 2 in outlying offices and 308 at the Ovoot Tolgoi Mine site. Of the 349 employees based in Mongolia, 343 (98%) are Mongolian nationals and of those, 155 (44%) are residents of the local Gurvantes, Dalanzadgad, Sevrei and Noyon Soums.

Development Projects and Exploration Program

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. 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 available on SEDAR 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 seams exhibit potential coking coal characteristics.

On July 6, 2011, the Company announced that the Mineral Resources Authority of Mongolia ("MRAM") issued the Company a mining license pertaining to the Soumber Deposit. The 10,993ha mining license was granted for an initial term of 30 years with an option for two 20 year extensions. In addition to the existing mining license, the Company also holds two exploration licenses pertaining to certain areas associated with the Soumber Deposit for which PMAs have been issued. The Company has applied for a mining license on the area covered by the PMA issued on January 18, 2013. The Company plans to progress to the mining license application process for the PMA issued on August 14, 2013.

Environmental baseline studies have been completed and general environmental impact assessments have been approved. The Company has delayed plans for a pre-feasibility study for the Soumber Deposit and intends to manage the feasibility planning and physical preparation of the Soumber Deposit with respect to ongoing market conditions, government requirements and the Company's available financial resources. The Company has engaged the relevant authorities in Mongolia concerning these planned delays.

5. Properties continued

Development Projects and Exploration Program continued

Zag Suuj Deposit

The Zag Suuj Deposit, located approximately 150km east of the Ovoot Tolgoi Mine and approximately 45km north of the Mongolia-China border, lies within the administrative units of Noyon and Bayandalai Soums in the Umnugobi Aimag (South Gobi Province).

Based on the exploration results to date, the coal occurrence at the Zag Suuj Deposit can be divided into four major seam groups. Each of the seam groups split into a number of coal plies of highly variable thickness, separated by stone partings. Interburden between the seams is mainly sandstone and conglomerate, whilst partings within the seams tend to be dominated by mudstone and carbonaceous mudstone. Correlation of the coal seams at the Zag Suuj Deposit with the Ovoot Tolgoi Deposit 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. 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 available on SEDAR 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 Company holds two exploration licenses pertaining to the Zag Suuj Deposit for which PMAs were issued on August 14, 2013 by MRAM. The Company plans to progress to the mining license application process for the PMAs.

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 2015. Exploration activities in 2015 will ensure to meet the requisite requirements under the Mongolian Minerals Law.

Ovoot Tolgoi Underground Deposit

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

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

5. Properties continued

Development Projects and Exploration Program continued

Ovoot Tolgoi Underground Deposit continued

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.

Aspire

Aspire is a company listed on the Australian Securities Exchange under the symbol AKM. In the fourth quarter of 2014, the Company raised a total of $2.8 million through the sale of 123.5 million shares held in Aspire Mining Limited. This reduced the Company's shareholding in Aspire Mining Limited to nil at December 31, 2014 down from 18.8% at December 31, 2013.

Exploration Program

The Company continued to minimize evaluation and exploration expenditures in 2014 in order to preserve the Company's financial resources. The 2015 exploration program will be limited to ensuring that the Company meets the Mongolian Minerals Law requirements in respect of its mining and exploration licenses including those related to the Soumber Deposit.

6. Liquidity and Capital Resources

Liquidity and Capital Management

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.

Turquoise Hill Loan Facility

On May 25, 2014, the Company announced it had obtained a $10 million revolving credit facility from Turquoise Hill to meet its short term working capital requirements. The terms and conditions of this facility were filed on SEDAR (www.sedar.com) on June 2, 2014. The key commercial terms of the facility were as follows:

- original maturity date of August 30, 2014 (subsequently extended);
- interest rate of one month US dollar LIBOR Rate in effect plus 11% margin per annum;
- commitment fee of 35% of interest rate payable quarterly in arrears on undrawn principal amount of facility;
- front end fee of $0.1 million;
- draws subject to customary closing conditions and the Company's cash requirements in the ordinary course of business;
- facility is subject to certain mandatory prepayment and termination provisions; and
- the Company to continue to seek other funding alternatives.

On August 30, 2014, subject to certain conditions and limitations, Turquoise Hill agreed to grant a deferral of payment of $3.8 million plus accrued interest thereon owing by the Company under the Turquoise Hill Loan Facility and reduced the revolving credit facility to the same $3.8 million. This deferral of payment and repayment is granted to the Company without prejudice to Turquoise Hill's right and ability to assert and re-assert at any point in time to demand payment and repayment of all amounts owing to Turquoise Hill under the Turquoise Hill Loan Facility.

6. Liquidity and Capital Resources continued

Liquidity and Capital Management continued

Turquoise Hill Loan Facility continued

Subsequently, on December 4, 2014 as a result of unavoidable delays in closing the NUR SPA, Turquoise Hill agreed to a further limited deferral of repayment on the $3.8 million principal and accrued interest owing on the Turquoise Hill Loan Facility as follows:

(i) $1.9 million in principal and all interest that has accrued on and under the Turquoise Hill Loan Facility up to and including May 30, 2015 shall become due and payable on May 30, 2015; and

(ii) $1.9 million in principal and all interest that has accrued on and under the Turquoise Hill Loan Facility from June 1, 2015 up to and including August 31, 2015 shall become due and payable on August 31, 2015.

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

As at December 31, 2014 the Company had drawn $3.8 million and owed accrued interest of $0.1 million under this facility (December 31, 2013: nil).

Private placements

December 2014 private placements

On December 3, 2014, the Company announced the successful completion of private placements with independent investors. The total gross proceeds from the private placements were US$9.0 million (US$8.9 million net after fees) through the issue of 24,360,773 Common Shares at CAD$0.42 per share.

The placing price of CAD$0.42 represented a discount of approximately 17.8% to the volume-weighted average price per Common Share of approximately CAD$0.51 as quoted on the TSX for the last five consecutive trading days immediately prior to December 3, 2014.

Novel Sunrise private placement

On February 24, 2015, the Company announced it has entered into a private placement agreement with Novel Sunrise providing for the initial subscription of 10,131,113 Mandatory Convertible Units for approximately US$3.5 million, and, upon the closing of the Novel SPA, described in further detail below, for the subscription of up to 11,618,887 Common Shares for additional gross proceeds of approximately US$4.0 million.

The initial tranche of the private placement consisting of approximately US$3.5 million of Mandatory Convertible Units closed on March 3, 2015 having been subject to regulatory approvals and other customary closing conditions. Each Mandatory Convertible Unit is convertible on a one for one basis into a Common Share, resulting in a deemed issue price of CAD$0.432 per Common Share ("Placing Price"). The Mandatory Convertible Units mandatorily convert into Common Shares upon either the closing of the Novel SPA or the termination thereof. The Mandatory Convertible Units do not have any voting rights until converted into Common Shares in accordance with their terms.

After the initial subscription and upon completion of the Novel SPA, Novel Sunrise has agreed to subscribe for up to an additional approximate US$4.0 million of Common Shares at the Placing Price (the "Subsequent Tranche") over a maximum period of 45 days from February 24, 2015, subject to regulatory approvals and other customary closing conditions. Assuming issuance of the full amount of Common Shares issuable under the Subsequent Tranche, the total gross proceeds of the placement will be approximately US$7.5 million. The proceeds from the private placement will be applied towards general working capital.

6. Liquidity and Capital Resources continued

Liquidity and Capital Management continued

Private placements continued

Novel Sunrise private placement continued

The Placing Price of CAD$0.432 represented a discount of approximately 20% to the 5-day volume-weighted average price per Common Share of approximately CAD$0.54, as of the date the Company received price protection from the TSX for the private placement. The Placing Price was determined with reference to the prevailing market price of the Common Shares and was negotiated on an arm's length basis between the Company's independent directors and Novel Sunrise.

The closing of the private placement and related transactions was subject to acceptance of notice of the placement by the TSX pursuant to the financial hardship provisions of the TSX Company Manual and the delisting review (For more information on the delisting review, refer to the heading "TSX Financial Hardship Exemption Application and Status of Listing on TSX" in this MD&A).

Under the private placement agreement, the Company has also agreed to grant Novel Sunrise the following additional rights:

- Mr. Ted Chan to join the Board contemporaneous with the closing of the initial tranche of the private placement as an Executive Director, subject to TSX approval;
- Two more nominees of Novel Sunrise to join the Board, plus additions to the Company's management team, upon closing of the Novel SPA;
- Novel Sunrise to have pro rata participation rights in future financings; and
- Novel Sunrise to have registration rights under Canadian provincial securities laws in connection with its shareholdings.

Mr. Chan was appointed as an Executive Director on March 3, 2015 and brings with him over 20 years of enterprise management experience. He has played a key role in the management of Novel Sunrise and its affiliated companies in China, particularly through establishing and managing client relationships. Mr. Chan holds a bachelor degree from Communication University of China.

Novel SPA

On February 24, 2015, the Company was advised by Novel Sunrise and Turquoise Hill that they had entered into a Sale and Purchase Agreement for the purchase by Novel Sunrise of 48,705,155 Common Shares currently held by Turquoise Hill. The closing of the Novel SPA is subject to certain terms and closing conditions including the approval of the TSX, obtaining clearance from the Hong Kong Securities and Futures Commission that the transactions contemplated by the proposed private placement and the Novel SPA will not trigger a mandatory general offer to the shareholders of the Company, and other customary conditions.

Assuming the Novel SPA and the private placement are completed, Novel Sunrise will hold 70,455,155 Common Shares, representing 29.3% of the expanded share capital of the Company, assuming full completion of the Novel Sunrise private placement and the issuance of 21,750,000 new Common Shares.

Going concern considerations

Notwithstanding the provision of the private placements, the coal prepayments received from customers and the Turquoise Hill Loan Facility, the Company continues to experience negative impacts on its margins and liquidity and there can be no assurance that the Company will have sufficient funding to be able to continue as a going concern.

6. Liquidity and Capital Resources continued

Liquidity and Capital Management continued

Going concern considerations continued

The Company anticipates that coal prices in China will remain under pressure in 2015, which will continue to impact the Company's margins and liquidity. Therefore the Company is actively seeking prepaid coal offtake agreements and other additional sources of financing to continue operating and meet its business objectives, while continuing to be focused on minimizing uncommitted capital expenditures and preserving the Company's growth options. The Company, together with its new strategic partner, Novel Sunrise Investments Ltd., has developed a funding plan (the "Proposed Funding Plan") in order to pay the interest due under the CIC Convertible Debenture, meet its obligations as they fall due and achieve its business objectives in 2015. These obligations may include potential penalties incurred as a consequence of the tax case in Mongolia (refer to section 7 "Regulatory Issues and Contingencies" for details). However, there is no guarantee that the Company will be able to implement this funding plan or secure other sources of financing. If it fails to do so, or is unable to secure additional capital or otherwise restructure or refinance its business in order to address its cash requirements through December 31, 2015, then the Company is unlikely to have sufficient capital resources or cash flows from mining operations in order to satisfy its ongoing obligations and future contractual commitments, including cash interest payments due on the CIC Convertible Debenture (approximately $7.9 million on May 19, 2015 and approximately $8.0 million on November 19, 2015). Refer to section 11 "Risk Factors". Therefore, the Company is actively seeking additional sources of financing to continue operating and meet its objectives.

The Company's consolidated financial statements have been prepared on a going concern basis which assumes that the Company will continue operating until at least December 31, 2015 and will be able to realize its assets and discharge its liabilities in the normal course of operations as they come due; however, in order to continue as a going concern, the Company must generate sufficient operating cash flows, secure additional capital or otherwise pursue a strategic restructuring, refinancing or other transaction to provide it with additional liquidity. If it fails to do so, or is unable to secure additional capital or otherwise restructure or refinance its business in order to address its cash requirements through December 31, 2015, then the Company is unlikely to have sufficient capital resources or cash flows from mining operations in order to satisfy its ongoing obligations and future contractual commitments, including cash interest payments due on the CIC Convertible Debenture, it may not be able to continue as a going concern.

If for any reason, the Company is unable to secure the additional sources of financing and continue as a going concern, then this could result in adjustments to the amounts and classifications of assets and liabilities in the Company's consolidated financial statements and such adjustments could be material.

While the Company intends to secure additional sources of financing as soon as possible, a continued delay in securing additional financing could ultimately result in an event of default of the $250 million CIC Convertible Debenture, which if not cured within applicable cure periods in accordance with the terms of such debenture, may result in the principal amount owing and all accrued and unpaid interest becoming immediately due and payable upon notice to the Company by CIC.

The Company is also subject to a remedial delisting review by the TSX in connection with its reliance on the financial hardship exemption from approval by its shareholders of the private placement with Novel Sunrise as announced on February 24, 2015. Refer to the below section "TSX Financial Hardship Exemption Application and Status of Listing on TSX" for details. The failure by the Company to clear the TSX delisting review within 90 days from February 25, 2015 may result in the Company's delisting which would result in an event of default under the CIC Convertible Debenture. An event of default may result in the principal amount owing and all accrued and unpaid interest becoming immediately due and payable upon notice to the Company by CIC.

6. Liquidity and Capital Resources continued

Liquidity and Capital Management continued

Going concern considerations continued

Factors that impact the Company's liquidity are being closely monitored 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.

As at December 31, 2014, the Company had cash of $3.8 million compared to cash of $21.8 million as at December 31, 2013. Working capital (excess current assets over current liabilities) was $3.4 million as at December 31, 2014 compared to $41.7 million as at December 31, 2013. As at March 30, 2015, the Company had cash of $4.2 million.

As at December 31, 2014, the Company's gearing ratio was 0.23 (December 31, 2013: 0.19), which was calculated based on the Company's long term liabilities to total assets. As at December 31, 2014, the Company is not subject to any externally imposed capital requirements.

Proposed Funding Plan

The Company has entered into the transaction with Novel Sunrise as a new significant shareholder and strategic partner intending to bring its operational and marketing expertise to the Company. Novel Sunrise, together with its affiliated companies in China, is a leading private enterprise in the real estate, logistics and supply chain management industries. In this connection, Novel Sunrise has agreed to assist the Company in the implementation of a funding plan intended to improve cash flow for the Company and support its business strategy and operations in a difficult market, with the goal of positioning the Company with a strong future as a coal producer. The proposed plan includes introducing potential customers in China to the Company to allow the Company to expand its customer base further inland in China, and helping the Company to secure longer-term coal offtake arrangements, thereby allowing the Company to ramp up production to capacity. Novel Sunrise has also advised the Company as part of the financing plan that it intends to help the Company to establish relationships with commercial banks in China and Hong Kong to help the Company to secure short term bridge loans, trading credit facilities and other types of financing.

While it is the Company's intention to proceed to implement the new funding plan with Novel Sunrise's assistance as soon as possible, the proposed plan is indicative only and the Company's ability to implement it successfully is dependent on a number of factors beyond its control, including but not limited to, China's economic growth and coal demand growth, market prices of coal, the availability of credit and market interest rates, and exchange rates of currencies of countries where the Company operates, and there can be no assurance that the Company will be able to do so, or that it will be able to do so in sufficient time to continue as a going concern. In such event, the Company is likely to be unable to meet its obligations, which could result in voluntary or involuntary insolvency proceedings involving the Company as discussed under the heading "Risk Factors" in the Management Discussion and Analysis issued on March 30, 2015 and available on SEDAR at www.sedar.com.

TSX Financial Hardship Exemption Application and Status of Listing on TSX

As Novel Sunrise are expected to hold greater than 20% of the Common Shares after the completion of the Novel SPA and the private placement – and, assuming China Investment Corporation does not elect to employ its pre-emptive or conversion rights under the $250 million debenture issued to it by the Company, Novel Sunrise would become the largest shareholder of the Company – the TSX has advised the Company that it takes the view that the private placement and the Novel SPA must be considered as one transaction, having a material effect on control of the Company, which normally would require the approval of a majority of disinterested shareholders under the provisions of the TSX Company Manual.

6. Liquidity and Capital Resources continued

TSX Financial Hardship Exemption Application and Status of Listing on TSX continued

On the basis that the Company is in serious financial difficulty and does not have sufficient time to obtain shareholder approval in a timely manner prior to the completion of the private placement and the Novel SPA, the Company applied to the TSX pursuant to the "financial hardship" provisions of section 604(e) of the TSX Company Manual for an exemption from the requirement to obtain shareholder approval for the private placement, the Novel SPA and the associated potential material effect on control.

On February 25, 2015, the TSX confirmed that the Company had been placed on remedial delisting review in connection with its reliance on the financial hardship exemption from approval by its shareholders of the private placement and advised the Company that its financial and operating results may not warrant that its securities continue to be listed on the TSX. A delisting review is customary practice under TSX policies when a listed company relies on the financial hardship exemption. SouthGobi has 90 days to comply with all requirements of the TSX for continued listing and a meeting of the TSX Continued Listing Committee to consider this matter has been scheduled for May 19, 2015. The Company believes the proceeds of the private placement will allow it to meet its short term financing needs and that it will be compliant with the continued listing requirements of the TSX within the 90 day compliance period following full completion of the private placement; however, no assurance can be provided as to the outcome of the remedial delisting review and the Company may become subject to delisting from the TSX.

CIC Convertible Debenture

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 approximately 21.5 million shares at a conversion price of $11.64 (Cdn$11.88). As at December 31, 2014, the CIC owned, through its indirect wholly owned subsidiary, approximately 17.3% of the issued and outstanding common shares of the Company.

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

Mongolian IAAC Investigation

In the first quarter of 2013, the Company was subject to orders imposed by Mongolia's Independent Authority against Corruption (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.

6. Liquidity and Capital Resources continued

Mongolian IAAC Investigation 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. Following a review by the Company and its advisers, it is the Company's view that this does not result in an event of default as defined under the CIC Convertible Debenture terms. However, if an event of default of the CIC Convertible Debenture occurs that remains uncured for ten business days, the principal amount owing and all accrued and unpaid interest will become immediately due and payable upon notice to the Company by CIC.

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

Cash Flow Highlights

$ in thousands	Year ended December 31, 2014	2013
Cash generated from/(used in) operating activities	**$ (29,673)**	$ 7,559
Cash used in investing activities	**(625)**	(4,892)
Cash generated from financing activities	**12,378**	129
Effect of foreign exchange rate changes on cash	**(128)**	(633)
Increase/(decrease) in cash for the year	**(18,048)**	2,163
Cash balance, beginning of year	**21,837**	19,674
Cash balance, end of year	**$ 3,789**	$ 21,837

Cash from/(used in) Operating Activities

The Company used $29.7 million of cash in operating activities in 2014 compared to cash generated from operating activities of $7.6 million in 2013.

In 2014, there was an increase in non-cash working capital of $0.9 million compared to a reduction of $33.0 million in 2013. In 2014, the Company reduced the level of trade and other payables by $13.5 million which was funded in part through the increase in deferred revenues from prepaid coal sales ($10.9 million) and the reduction in prepaid expenses and deposits ($0.9 million). The reduction in prepaid expenses and deposits in 2014 includes the impact of the reclassification of restricted cash of $1.2 million from cash to prepaid expenses and deposits. In 2013, the Company reduced its prepaid expenses and deposits by $22.6 million and increased its trade and other payables ($19.9 million) following the ramp-up in operating activities in 2013 compared to the end of 2012.

Cash used in Investing Activities

For 2014, the Company used $0.6 million of cash in investing activities compared to $4.9 million for 2013. In 2014, expenditures on property, plant and equipment (including capitalized deferred stripping activities) totaled $2.8 million and investments in RDCC LLC were $2.5 million. These expenditures were partially offset by net proceeds of $1.3 million generated from the sale of the Tsagaan Tolgoi mining license which was completed in the second quarter of 2014. In comparison, for 2013, expenditures on plant, property and equipment (including capitalized deferred stripping activities) of $11.8 million and investments in RDCC LLC of $10.4 million were partially offset by proceeds from maturing investments of $15.4 million.

6. Liquidity and Capital Resources continued

Cash Flow Highlights continued

Cash generated from Financing Activities

The cash generated from financing activities in the 2014 primarily related to the proceeds from the private placement of $8.6 million and the revolving credit facility obtained from Turquoise Hill ("Turquoise Hill Loan Facility"). At December 31, 2014, the Company had drawn down $3.8 million under this facility and is no longer eligible to make further withdrawals.

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. As at December 31, 2014, the Company's operating and capital commitments were:

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

Ovoot Tolgoi Mine Impairment Analysis

Unchanged from the assessment made as at December 31, 2013, March 31, 2014, June 30, 2014 and September 30, 2014 respectively, the Company determined that an indicator of impairment existed for its Ovoot Tolgoi Mine cash generating unit as at December 31, 2014. The impairment indicator was the continued weakness in the Company's share price during the fourth quarter of 2014 and the fact that the market capitalization of the Company, as at December 31, 2014, was less than the carrying value of its net assets.

Therefore, the Company conducted an impairment test whereby the carrying value of the Company's Ovoot Tolgoi Mine cash generating unit was compared to its "value in use" using a discounted future cash flow valuation model. The Company's cash flow valuation model has been updated to take into consideration the latest available information to the Company, including but not limited to, sales price, sales volumes and washing assumptions, operating cost assumptions and life of mine coal production assumptions as at December 31, 2014. The Company's Ovoot Tolgoi Mine cash generating unit carrying value was $358.6 million as at December 31, 2014.

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

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

6. Liquidity and Capital Resources continued

Ovoot Tolgoi Mine Impairment Analysis continued

Key sensitivities in the valuation model are as follows:

- For each 1% increase/(decrease) in the long term price estimates, the calculated fair value of the cash generating unit increases/(decreases) by approximately \$19.3/(\$19.3) million;
- For each 1% increase/(decrease) in the discount rate, the calculated fair value of the cash generating unit (decreases)/increases by approximately (\$25.0)/\$27.5 million; and
- For each 1% increase/(decrease) in the cash mining cost estimates, the calculated fair value of the cash generating unit (decreases)/increases by approximately (\$10.8)/\$10.8 million.

The impairment analysis did not result in the identification of an impairment loss and no charge was required as at December 31, 2014. A decline of more than 1% in the long term price estimates, an increase of more than 1% in the pre-tax discount rate or an increase of more than 2% in the cash mining cost estimates may trigger an impairment charge on the cash generating unit. The Company believes that the estimates and assumptions incorporated in the impairment analysis are reasonable; however, the estimates and assumptions are subject to significant uncertainties and judgments.

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

Investment in RDCC LLC Impairment Analysis

The Company determined that an indicator of impairment existed for its investment in RDCC LLC as at December 31, 2014. The impairment indicator was the continued delay in the commencement of operation.

Therefore, the Company conducted an impairment test whereby the carrying value of the Company's investment in RDCC LLC compared to its "value in use" using a discounted future cash flow valuation model. The carrying value was \$26.6 million as at December 31, 2014.

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

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

Key sensitivities in the valuation model are as follows:

- For each 1% increase/(decrease) in the toll fee estimates or traffic volume, the calculated fair value of the carrying unit increases/(decreases) by approximately \$0.3/(\$0.3) million; and
- For each 1% increase/(decrease) in the discount rate, the calculated fair value of the carrying unit (decreases)/increases by approximately (\$1.5)/\$1.7 million.

The impairment analysis did not result in the identification of an impairment loss and no charge was required as at December 31, 2014. The Company believes that the estimates and assumptions incorporated in the impairment analysis are reasonable; however, the estimates and assumptions are subject to significant uncertainties and judgments.

6. Liquidity and Capital Resources continued

Financial Instruments

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

The fair values of financial instruments that are traded on an active liquid market are determined with reference to the quoted market prices. The fair value of the Company's investment in the shares of Kangaroo Resources Limited ("Kangaroo") and Aspire was determined using this methodology. The Company's investment in the shares of Kangaroo and its money market investments were classified as fair value through profit or loss ("FVTPL"). The Company's investment in the shares of Aspire was classified as available-for-sale. The Company disposed all its investment in Aspire and Kangaroo during 2014 and did not hold any Aspire or Kangaroo shares as at December 31, 2014.

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.

$ in thousands	As at December 31 2014	2013
Financial assets		
Loans-and-receivables		
Cash	**$ 3,789**	$ 21,837
Trade and other receivables	**462**	2,578
Available-for-sale		
Investment in Aspire	**–**	6,175
Fair value through profit or loss		
Investment in Kangaroo	**–**	222
Total financial assets	**$ 4,251**	$ 30,812

$ in thousands	As at December 31 2014	2013
Financial liabilities		
Fair value through profit or loss		
Convertible debenture – embedded derivatives	**$ 1,834**	$ 3,395
Other-financial-liabilities		
Trade and other payables	**18,124**	31,241
Interest-bearing borrowing	**3,945**	–
Convertible debenture – debt host	**93,353**	93,208
Total financial liabilities	**$ 117,256**	$ 127,844

6. Liquidity and Capital Resources continued

Financial Instruments continued

The net loss in 2014 and 2013 included the following amounts of unrealized losses/(gains) from the fair value adjustments to certain financial instruments which are classified as FVTPL:

$ in thousands	Three months ended December 31, 2014	2013	Year ended December 31, 2014	2013
Unrealized loss on FVTPL investments	**$ –**	$ 60	**$ –**	$ 656
Unrealized gain on embedded derivatives in CIC convertible debenture	**(308)**	(1,278)	**(1,560)**	(5,481)

The Company recognized impairment losses of $1.8 million and $3.1 million in other operating expenses in 2014 and 2013 related to the investment in Aspire, respectively.

7. Regulatory Issues and Contingencies

Regulatory Issues

Governmental and Regulatory Investigations

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

While the IAAC has not made any formal accusations against any current or former employee of the Company or the Company under the Anti-Corruption Case, administrative penalties were imposed on certain of the Company's Mongolian assets in connection with the investigation, including a restriction of the use of US$1.2 million (the "Restricted Funds") held in bank accounts in Mongolia to spending in Mongolia. The Company has been informed that the Anti-Corruption Case has been suspended; however, it has not received formal notice that the investigation is completed and the restriction on the Restricted Funds remains in place. The Restricted Funds are included within the prepaid expenses and deposits balance in the Company's financial statements. This restriction may have a material impact on the Company's activities in light of the Tax Penalty.

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

7. Regulatory Issues and Contingencies continued

Regulatory Issues continued

Governmental and Regulatory Investigations continued

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

The Tax Verdict declared SGS to be financially liable as a "civil defendant" for a penalty (the "Tax Penalty") of MNT35.3 billion (approximately US$18.2 million on February 1, 2015). The Company firmly rejects this conclusion. On February 18, 2015, the Company appealed the Tax Verdict (the "Tax Verdict Appeal") on the grounds that it has prepared its financial statements, including those of SGS, in compliance with IFRS, and lodged all its tax returns in the required format under Mongolian tax law. The hearing of the Tax Penalty Appeal took place on March 25, 2015 at the 10th Appeal Court for Criminal Case of Mongolia (the "Court of Appeal") and a panel of three appointed judges decided to uphold the Tax Verdict and dismissed the Tax Verdict Appeal by the Company. As of the date of this MD&A, the Court of Appeal has not provided any explanation of its reasoning to uphold the Tax Verdict and the Company is awaiting a written version of the Appeal Court's verdict ("Appeal Verdict"). It is the view of the Company that there is a lack of evidence to support both the Tax Verdict and the Appeal Verdict.

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

The consequences for the Company of the Tax Verdict and the Appeal Verdict are uncertain. If the Tax Verdict is not reversed on final appeal, or if the amount of the Tax Penalty is not reduced upon exhaustion of the foregoing appeal process, the Company may not be able to pay the Tax Penalty or the final assessed amount, which could result in voluntary or involuntary insolvency proceedings involving the Company. For further information see the Risk Factor entitled "If the Company is unsuccessful in appealing the Tax Verdict it will likely not have sufficient cash resources to satisfy the penalty imposed thereunder" in this MD&A.

Internal Investigations

Through its Audit Committee (comprised solely of independent directors), the Company has conducted an internal investigation into possible breaches of law, internal corporate policies and codes of conduct arising from the allegations which have been raised through the investigations in Mongolia. The Chair of the Audit Committee has also participated in a tripartite committee, comprised of the Audit Committee Chairs of the Company and Turquoise Hill and a representative of Rio Tinto, which focused on the investigation of a number of those allegations, including possible violations of anti-corruption laws. The tripartite committee substantially completed the investigative phase of its activities during the third quarter of 2013. There have been no significant developments in respect of the internal investigations since the completion of the investigative phase during the third quarter of 2013.

7. Regulatory Issues and Contingencies continued

Regulatory Issues continued

Governmental and Regulatory Investigations continued

The investigations referred to above could result in one or more Mongolian, Canadian, United States or other governmental or regulatory agencies taking civil or criminal action against the Company, its affiliates or its current or former employees. The likelihood or consequences of such an outcome are unclear at this time but could include financial or other penalties, which could be material, and which could have a material adverse effect on the Company. Refer to the Company's MD&A for the year ended December 31, 2013, which is available on SEDAR at www.sedar.com, section 14 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".

Mining Prohibition in Specified Areas Law

Pursuant to the Mining Prohibition in Specified Areas Law, the Government of Mongolia has defined the boundaries of certain areas in which exploration and mining is purportedly prohibited. A 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.

Portions of the Company's Ovoot Tolgoi mining license and exploration licenses pertaining to the Zag Suuj Deposit and the South Biluut and Jargalant Fields within the Soumber Deposit are included on the list of licenses published by the Government of Mongolia, potentially affecting the status of those licenses under the Mining Prohibition in Specified Areas Law.

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.

The Company understands that as such the amendment will be effective as of March 17, 2015. However, the status of the Mining Prohibition in Specified Areas Law and its potential impact on the Company's licenses is unclear. An amendment to the Implementation Policy on the Mining Prohibition in Specified Areas Law was made on February 18, 2015. The Company will ensure that it follows the necessary steps in the Implementation Policy to secure its operations and licenses and is fully compliant with Mongolian law.

Contingencies

Class Action Lawsuit

On or about January 6, 2014, Siskinds LLP, a Canadian law firm, filed a proposed securities class action (the "Ontario Action") against the Company, certain of its former senior officers and current directors, and its former auditors, Deloitte LLP, in the Ontario Superior Court of Justice in relation to the Company's restatement of financial statements as previously disclosed in the Company's public filings.

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

7. Regulatory Issues and Contingencies continued

Contingencies continued

Class Action Lawsuit continued

The Company disputes and will vigorously defend itself against these claims through independent Canadian litigation counsel retained by the Company and the other defendants for this purpose. Due to the inherent uncertainties of litigation, it is not possible to predict the final outcome of the Ontario Action or determine the amount of any potential losses, if any. However, the Company has judged a provision for this matter at December 31, 2014 is not required.

8. 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 the 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 management plan (including reclamation measures) in co-operation with the Ministry of Environment, Green Development and Tourism, which should take into account the results of the environmental impact assessment. The Company received approval of its detailed Environmental Impact Assessment and Environmental Management Plan from the Mongolian Ministry of Environment for the mining operation at the Ovoot Tolgoi Mine in 2007 and renewed in 2013.

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. In accordance with new provisions specified in Mongolian laws and regulations, the Company has developed a protection strategy jointly with professional organization for a whole year of 2014. This strategic plan can serve as a policy document directed to protection of biological diversity, ecosystem balance and its preservation; and support species dwelling nearby the Ovoot Tolgoi mine area.

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.

9. Related Party Transactions

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

- Turquoise Hill – Turquoise Hill is the Company's immediate parent company and at December 31, 2014 owned approximately 48% of the outstanding common shares of the Company. Turquoise Hill provides various administrative services to the Company on a cost-recovery basis.
- Rio Tinto – Rio Tinto is the Company's ultimate parent company and at December 31, 2014 Rio Tinto controlled Turquoise Hill. The Company recovers administration and other costs incurred on behalf of Rio Tinto on a cost-recovery basis. Rio Tinto recovers from the Company the costs of salaries and benefits of employees assigned to work for the Company and recovers legal and professional fees from the Company in respect of the internal and tripartite committees referred to in section 6 "Regulatory Issues and Contingencies".
- Turquoise Hill Resources Singapore Pte. Ltd. ("Turquoise Hill Singapore") – Turquoise Hill Singapore (formerly I2MS.NET Pte. Ltd.) is a private company 100% owned by Turquoise Hill. Turquoise Hill Singapore provides information technology and other related services to the Company on a cost-recovery basis.
- Global Mining Management ("GMM") – On October 31, 2013, the Company and Turquoise Hill ceased being shareholders of GMM, a private company. GMM was owned equally by seven companies, two of which included the Company and Turquoise Hill. GMM provided administration, accounting and other office services to the Company on a cost-recovery basis. The provision of these services ceased on October 31, 2013.

The following tables summarize related party expense and recovery amounts with the related parties listed above:

	Year ended December 31, 2014	2013
Corporate administration	**$ 711**	$ 781
Salaries and benefits	**1,392**	1,505
Finance cost	**416**	–
Related party expenses	**$ 2,519**	$ 2,286

	Year ended December 31, 2014	2013
GMM	**$ –**	$ 40
Turquoise Hill	**513**	205
Rio Tinto	**1,392**	1,353
Turquoise Hill Singapore	**614**	688
Related party expenses	**$ 2,519**	$ 2,286

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

9. Related Party Transactions continued

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

As at December 31, 2014, the Company had accounts receivable of nil (December 31, 2013: $0.1 million), accounts payable of $12.5 million (December 31, 2013: $1.4 million) and amounts classified as interest bearing loans and borrowings totaling $3.8 million as at December 31, 2014, (December 31, 2013: nil) with related parties. Included in the $12.5 million accounts payable as at December 31, 2014 are $5.3 million of legal and professional fees payable to Rio Tinto in respect of the internal and tripartite committees referred to in section 6 "Regulatory Issues and Contingencies".

Emolument Policy

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

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

The Company has also adopted an equity incentive plan to incentivize directors and eligible employees. Details of the plan are set out in note 23 of the Company's consolidated financial statements for the year ended December 31, 2014.

10. Outstanding Share Data

The Company is authorized to issue an unlimited number of common shares without par value and an unlimited number of preferred shares without par value. As at March 30, 2015, 218.8 million common shares were issued and outstanding. There are also incentive share options outstanding to acquire 3.1 million unissued common shares with exercise prices ranging from Cdn$0.58 to Cdn$12.58. There are no preferred shares outstanding.

As at March 30, 2015, Turquoise Hill directly owned 104.8 million common shares representing approximately 48% of the issued and outstanding common shares of the Company.

On December 2, 2014, an amendment to the SPA was agreed. According to the SPA, NUR has agreed to purchase 56,102,000 shares from Turquoise Hill.

Further, on February 25, 2015, Novel Sunrise has agreed with Turquoise Hill to purchase 48,705,155 shares from Turquoise Hill.

Upon closing of the transaction on i) the sale of 56,102,000 shares between Turquoise Hill and NUR; and ii) the sale of 48,705,155 shares between Turquoise Hill and Novel Sunrise, the number of shares held by Turquoise Hill is expected to reduce to nil.

10. Outstanding Share Data continued

On December 3, 2014, the Company announced the successful completion of private placements with independent investors. The total gross proceeds from the private placements were $9.0 million ($8.9 million net after fees) through the issue of 24,360,773 Common Shares at CAD$0.42 per share.

On February 24, 2015, the Company announced it has entered into a private placement agreement with Novel Sunrise as a proposed new significant investor and strategic partner for proceeds of up to approximately $7.5 million through the issue (or deemed issue) of up to of 21,750,000 Common Shares at CAD$0.432 per share.

11. Internal Controls Over Financial Reporting

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

Management, including the Executive Director and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures. As of December 31, 2014, Executive Director and Chief Financial Officer have each concluded that the Company's disclosure controls and procedures, as defined in NI 52-109 – Certification of Disclosure in Issuer's Annual and Interim Filings, are effective to achieve the purpose for which they have been designed.

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

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

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

Management assessed the effectiveness of internal control over financial reporting using the Internal Control – Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that the Company's internal control over financial reporting was effective as of December 31, 2014.

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

12. Critical Accounting Estimates and Judgments

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

A detailed summary of all of the Company's significant accounting policies is included in note 3 to the Company's consolidated financial statements for the year ended December 31, 2014. Information about judgments and estimates in applying accounting policies that have the most significant effect on the amounts recognized in the consolidated financial statements are as follows:

Liquidity and Going Concern Assumption

In the determination of the Company's ability to meet its ongoing obligations and future contractual commitments, management relies on the Company's planning, budgeting and forecasting process to help determine the funds required to support the Company's normal operations on an ongoing basis and its expansionary plans. The key inputs used by the Company in this process include forecasted capital deployment, results from operations, results from the exploration and development of its properties and general industry conditions.

Several adverse conditions and material uncertainties cast significant doubt upon the going concern assumption. The Company had limited cash of $3.8 million at December 31, 2014 and anticipates that coal prices in China will remain under pressure in 2015, which will continue to impact the Company's margins and liquidity. Therefore the Company is actively seeking prepaid coal offtake agreements and other additional sources of financing to continue operating and meet its business objectives, while continuing to be focused on minimizing uncommitted capital expenditures and preserving the Company's growth options. The Company, together with its new strategic partner, Novel Sunrise, has developed the Proposed Funding Plan in order to pay the interest due under the CIC Convertible Debenture, meet its obligations as they fall due and achieve its business objectives in 2015. These obligations may include potential penalties incurred as a consequence of the tax case in Mongolia (refer to section 7 "Regulatory Issues and Contingencies" for details). However, there is no guarantee that the Company will be able to implement the Proposed Funding Plan or secure other sources of financing. If it fails to do so, or is unable to secure additional capital or otherwise restructure or refinance its business in order to address its cash requirements through December 31, 2015, then the Company is unlikely to have sufficient capital resources or cash flows from mining operations in order to satisfy its ongoing obligations and future contractual commitments, including cash interest payments due on the CIC Convertible Debenture (approximately $7.9 million on May 19, 2015 and approximately $8.0 million on November 19, 2015). As a result, the Company may not be able to continue as a going concern.

The Company's consolidated financial statements have been prepared on a going concern basis which assumes that the Company will continue operating until at least December 31, 2015 and will be able to realize its assets and discharge its liabilities in the normal course of operations as they come due; however, in order to continue as a going concern, the Company must generate sufficient operating cash flows, secure additional capital or otherwise pursue a strategic restructuring, refinancing or other transaction to provide it with additional liquidity. If it fails to do so, or is unable to secure additional capital or otherwise restructure or refinance its business in order to address its cash requirements through December 31, 2015, then the Company is unlikely to have sufficient capital resources or cash flows from mining operations in order to satisfy its ongoing obligations and future contractual commitments, including cash interest payments due on the CIC Convertible Debenture. As a result, it may not be able to continue as a going concern.

If for any reason, the Company is unable to secure the additional sources of financing and continue as a going concern, then this could result in adjustments to the amounts and classifications of assets and liabilities in the Company's consolidated financial statements and such adjustments could be material.

12. Critical Accounting Estimates and Judgments continued

Liquidity and Going Concern Assumption continued

While the Company intends to secure additional sources of financing as soon as possible, a continued delay in securing additional financing could ultimately result in an event of default of the $250.0 million CIC Convertible Debenture, which if not cured within applicable cure periods in accordance with the terms of such debenture, may result in the principal amount owing and all accrued and unpaid interest becoming immediately due and payable upon notice to the Company by CIC.

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

Valuation of Embedded Derivatives

The embedded derivatives in the Company's Convertible Debenture are valued using a Monte Carlo simulation valuation model. A Monte Carlo simulation model is a valuation model that relies on random sampling and is often used when modeling systems with a large number of inputs and where there is significant uncertainty in the future value of inputs and where the movement of the inputs can be independent of each other. The key inputs used by the Company in its Monte Carlo simulation are further disclosed in note 20.2 and note 20.3 of the Company's consolidated financial statements for the year ended December 31, 2014. Changes in the inputs to the valuation model could impact the carrying value of the embedded derivatives in the Convertible Debenture and the amount of unrealized gains or losses recognized in profit or loss.

Review of Carrying Value of Assets and Impairment Charges

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

Prepaid Toll Washing Fees

Refer to section 5 "Processing Infrastructure – Wet Washing Facility" for further analysis of the $3.4 million impairment loss recorded on the prepaid toll washing fees which are part of the contract with Ejin Jinda.

Ovoot Tolgoi Mine Cash Generating Unit

Refer to section 6 "Liquidity and Capital Resources – Ovoot Tolgoi Mine Impairment Analysis" for further analysis of the impairment test performed as at December 31, 2014.

Investment in RDCC LLC

Refer to section 6 "Liquidity and Capital Resources – Investment in RDCC LLC Impairment Analysis" for further analysis of the impairment test performed as at December 31, 2014.

12. Critical Accounting Estimates and Judgments continued

Estimated Recoverable Reserves

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

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

Useful Lives and Depreciation Rates for Property, Plant and Equipment

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

Income Taxes and Recoverability of Deferred Tax Assets

Actual amounts of income tax expense are not final until tax returns are filed and accepted by the taxation authorities. Therefore, profit or loss in future reporting periods will be affected by the amount that income tax expense estimates differ from the final tax returns. Judgment is required in determining whether deferred tax assets are recognized on the statement of financial position. Deferred tax assets, including those arising from unutilized tax losses, require management of the Company to assess the likelihood that the Company will generate sufficient taxable profit in future periods in order to utilize recognized deferred tax assets. Estimates of future taxable profit are based on forecast cash flows from operations and the application of existing tax laws in each jurisdiction. To the extent that future cash flows and taxable profit differ from estimates, the ability of the Company to realize the deferred tax assets recorded on the statement of financial position could be impacted.

13. Recent Accounting Pronouncements

The Company has adopted the new and revised standards and interpretations issued by the IASB listed below effective January 1, 2014. These changes were made in accordance with the transitional provisions outlined in the respective standards and interpretations.

IFRIC 21 Levies

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

Annual Improvements 2010-2012 Cycle

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

14. RISK FACTORS

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

Risks Relating to the Company's Ability to Continue as a Going Concern

Unless the Company acquires additional sources of financing and/or funding in the short term, the ability of the Company to continue as a going concern is threatened.

Specifically adverse conditions and material uncertainties cast significant doubt upon the going concern assumption contained in the Company's financial statements. The Company had limited cash of $3.8 million at December 31, 2014 and anticipates that coal prices in China will remain under pressure through 2015, which will continue to impact the Company's margins and liquidity. The Company's consolidated financial statements have been prepared on a going concern basis which assumes that the Company will continue operating until at least December 31, 2015 and will be able to realize its assets and discharge its liabilities in the normal course of operations as they come due. While the Company is actively seeking prepaid coal offtake agreements and other additional sources of financing to continue operating and meet its objectives, there can be no assurance that such financing will be available on terms acceptable to the Company. Moreover, the Company's ability to successfully implement, and the cost of, any such transaction will depend on numerous factors, including the demand and prices for its coal products, general economic conditions, the strength of the credit and capital markets, its ability to successfully execute its funding plan and meet its operating and financial targets, its ability to remain in compliance with the Convertible Debenture, the operational synergies created by its association with Novel Sunrise and implementation of the Proposed Funding Plan, its ability to maintain relationships with its suppliers, customers, employees, stockholders and other third parties, and market and investor confidence as to its ability to continue as a going concern.

14. RISK FACTORS continued

Risk Relating to the Company's Ability to Continue as a Going Concern continued

Unless the Company acquires additional sources of financing and/or funding in the short term, the ability of the Company to continue as a going concern is threatened. continued

Notwithstanding the proceeds from the December 2014 private placement and the initial tranche of the Novel Sunrise private placement, the Turquoise Hill shareholder loan facility, and certain coal prepayments received from customers, the Company continues to experience negative impacts on its margins and liquidity. Therefore, there can be no assurance that the Company will have sufficient funding to be able to continue as a going concern, including the interest payment on the Convertible Debenture, which is approximately $8 million due on each of May 19, 2015 and November 19, 2015.

In addition to the implementation of the Proposed Funding Plan, the Company has in place planning, budgeting and forecasting processes to help determine the funds required to support the Company's normal operations on an ongoing basis and its expansionary plans. Assuming successful implementation of the Proposed Funding Plan (see risk factor described in "RISK FACTORS-Risk Relating to the Company's Ability to Continue As A Going Concern – "The Proposed Funding Plan may not be successfully implemented" in this MD&A) and based the projections from these processes for the year ended December 31, 2015, the Company is still unlikely to have sufficient capital resources and does not expect to generate sufficient cash flows from mining operations in order to satisfy its ongoing obligations, future contractual commitments, including cash interest payments due on the CIC Convertible Debenture, and potential monetary penalty imposed in respect of the Tax Penalty.

The Company expects the receipt of the approximate $4.0 million cash proceeds underlying the Subsequent Tranche of the Novel Sunrise private placement will assist the Company in meeting its objective; however, the Company notes that the funding of such tranche is conditional upon the occurrence of certain events that are outside of its control, and there is no assurance that these conditions will be fulfilled. Therefore, the Company must continue to actively seek additional sources of financing and/or coal prepayments to continue operating and meet its objectives. For a description of the Novel Sunrise private placement refer to "LIQUIDITY AND CAPITAL RESOURCES – Liquidity and Capital Management – Private Placement – Novel Sunrise Private Placement" in this MD&A.

If for any reason, the Company is unable to secure the additional sources of financing and continue as a going concern, then this could result in adjustments to the amounts and classifications of assets and liabilities in the Company's consolidated financial statements and such adjustments could be material. If the Company is unable to continue as a going concern, it would likely need to seek relief under applicable bankruptcy and insolvency legislation, which may negatively affect the price and volatility of the Common Shares and any investment in such shares could suffer a significant decline or total loss in value.

14. RISK FACTORS continued

Risk Relating to the Company's Ability to Continue as a Going Concern continued

The Proposed Funding Plan may not be successfully implemented.

While it is the Company's intention to proceed to implement the Proposed Funding Plan as soon as possible and assuming the Subsequent Tranche is completed, such plan is indicative only and the Company's ability to implement it successfully is dependent on a number of factors beyond its control, including but not limited to, the China's economic growth and coal demand growth, market prices of coal, the availability of credit and market interest rates, and exchange rates of currencies of countries where the Company operates. In particular, the Company anticipates that coal prices in China will remain under pressure through 2015, which will continue to impact the Company's margins and liquidity. If the Company in unable to successfully implement the Proposed Funding Plan, the Company would not likely be able to continue as a going concern and would likely need to seek relief under applicable bankruptcy and insolvency legislation, which may negatively affect the price and volatility of the Common Shares and any investment in such shares could suffer a significant decline or total loss in value. For more information on the Proposed Funding Plan, refer to "LIQUIDITY AND CAPITAL RESOURCES – Liquidity and Capital Management – Proposed Funding Plan" in this MD&A.

As a consequence of the Novel Private Placement and the series of related transactions, the Company is subject to mandatory de-listing review by the TSX, which could ultimately result in the delisting of the Common Shares from the TSX and the occurrence of an event of default under the Convertible Debenture, which events threaten the Company's ability to continue as a going concern.

Assuming completion of the Subsequent Tranche and completion of the acquisition of Common Shares by Novel Sunrise under the Novel SPA, Novel Sunrise will become the Company's largest shareholder with a 29.3% equity interest. As a result, the TSX views the Novel Sunrise private placement and the Novel SPA as one transaction and one that would have a material effect on control of the Company, which normally would require the approval of a majority of disinterested Shareholders under the provisions of the TSX Company Manual. Given the serious financial difficulty faced by the Company and the time delay inherent in holding a shareholder meeting to approve the transaction, the Company relied on the TSX's financial hardship exemption to avoid the requirement to obtain Shareholder approval.

As a result of the Company's reliance on the financial hardship exemption from the requirement to obtain Shareholder approval, the TSX has placed the Company under remedial delisting review. A delisting review is customary practice under TSX policies when a listed company requests relief in reliance on this exemption. The Company is currently in discussions with TSX staff to demonstrate the long term viability of the Company. The Company is confident that the business synergies emerging from its association with Novel Sunrise and the implementation of the Proposed Funding Plan will allow it to demonstrate its long term viability and to successfully clear the delisting review. However, if the Company is not successful in clearing the TSX delisting review by May 19, 2015, subject to possible extension, the Common Shares may be delisted from the TSX. The Company notes that any such delisting would result in an event of default under the Convertible Debenture, thereby allowing CIC to declare the principal and accrued interest owing thereunder immediately due and payable. The Company does not currently have the financial resources to satisfy the payment of all sums owing under the Convertible Debenture, and if the same were declared due and payable, the Company would not likely be able to continue as a going concern and would likely need to seek relief under applicable bankruptcy and insolvency legislation, which may negatively affect the price and volatility of the Common Shares and any investment in such shares could suffer a significant decline or total loss in value.

For a description of the Novel SPA refer to "LIQUIDITY AND CAPITAL RESOURCES – Liquidity and Capital Management – Novel SPA" in this MD&A.

14. RISK FACTORS continued

Risk Relating to the Company's Ability to Continue as a Going Concern continued

Tax legislation in Mongolia is subject to varying interpretations and changes which may have a significant impact on the Company's financial position.

Mongolian tax, currency and customs legislation is subject to varying interpretations and changes, which can occur frequently. The interpretation by the Company' s management of such legislation as applied to the transactions and activity of the Company may be challenged by the relevant authorities.

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

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

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

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

If the Company is unsuccessful in a final appeal of Tax Verdict it will likely not have sufficient cash resources to satisfy the penalty imposed thereunder.

On February 4, 2015, the Company received the Tax Verdict from the District Court confirming the outcome of the criminal trial of the Former Employees and against SGS as a "civil defendant". The District Court pronounced the Former Employees guilty of tax evasion and sentenced such individuals to prison for periods ranging from 5 years and six months to 5 years and 10 months. In addition, SGS was held financially liable for the Tax Penalty under the Tax Verdict.

The Company announced on February 18, 2015 that it had appealed the Tax Verdict related to SGS. The Company has been informed that the Former Employees requested and received pardons from the President of Mongolia. These pardons were granted on the condition that the individuals not appeal the Tax Verdict as it applied to them. The Tax Verdict related to SGS was upheld at the hearing of the appeal on March 25, 2015. It is the view of the Company that there is a lack of evidence to support both the Tax Verdict and the Appeal Verdict and, accordingly, the Company will continue to defend itself through all available legal means including a final appeal.

14. RISK FACTORS continued

Risk Relating to the Company's Ability to Continue as a Going Concern continued

If the Company is unsuccessful in a final appeal of Tax Verdict it will likely not have sufficient cash resources to satisfy the penalty imposed thereunder. continued

The consequences for the Company of the Tax Verdict, the Appeal Verdict and the decision of the Supreme Court to hear a final appeal are uncertain. If the Appeal Verdict is not reversed on final appeal, or if the amount of the Tax Penalty is not reduced upon exhaustion of the foregoing appeal process, the Company may not be able to pay the Tax Penalty or the final assessed amount, which could result in voluntary or involuntary insolvency proceedings involving the Company. For further information see the Risk Factor entitled "If the Company is unsuccessful in appealing the Tax Verdict it will likely not have sufficient cash resources to satisfy the penalty imposed thereunder".

The Company remains confident in the merits of the final appeal of the Tax Verdict; however, if such appeal is not successful and SGS is required to pay the Tax Penalty, neither SGS nor the Company on its behalf is likely to have sufficient cash resources to satisfy such penalty. In such circumstances, all of the assets of SGS may become subject of seizure by Mongolian authorities in the enforcement of the Tax Penalty. Any enforcement of the Tax Penalty would likely impair the Company's ability to continue as a going concern and the Company would likely need to seek relief under applicable bankruptcy and insolvency legislation, which may negatively affect the price and volatility of the Common Shares and any investment in such shares could suffer a significant decline or total loss in value.

For a description of the Tax Penalty, Tax Verdict, the Appeal Verdict and Former Employees and matters relating thereto, refer to "REGULATORY ISSUES AND CONTINGENCIES – Regulatory Issues – Governmental and Regulatory Issues" in this MD&A.

Due to the inherent uncertainties of litigation, it is not possible to predict the final outcome of the Ontario Action or determine the amount of any potential losses, if any.

In January 2014, Siskinds LLP, a Canadian law firm, filed the Ontario Action against the Company, certain of its former senior officers and current directors, and its former auditors, Deloitte LLP, in the Ontario Superior Court of Justice (the "Ontario Court") in relation to the Company's restatement of financial statements as previously disclosed in the Company's public filings.

The plaintiff seeks leave to bring a claim under applicable Canadian securities legislation and seeks certification of a class action with respect to a class of persons who purchased shares of the Company between March 30, 2011 and November 7, 2013, alleging that the financial reporting of the Company during that period contained misrepresentations giving rise to liability at common law and under applicable Canadian securities legislation. The Ontario Action also seeks general damages against all defendants in the sum of Cdn$30 million, without particulars as to how such amount was determined, or such other amount that the Ontario Court deems appropriate. The motions for leave and certification will be heard in Toronto on June 17, 18 and 19, 2015. Assuming that leave is granted, the action is certified as a class proceeding, and there is a finding of liability, the actual quantum of damages will depend upon the evidence which is adduced in the court proceedings.

14. RISK FACTORS continued

Risk Relating to the Company's Ability to Continue as a Going Concern continued

Due to the inherent uncertainties of litigation, it is not possible to predict the final outcome of the Ontario Action or determine the amount of any potential losses, if any. continued

Named in the Ontario Class Action as individual defendants are the Company's former Chief Executive Officer, Alexander Molyneux, the Company's former Chief Financial Officers, Messrs. Terry Krepiakevich and Matthew O'Kane, and the members of its Audit Committee, Messrs. André Deepwell, Pierre Lebel and Gordon Lancaster, each of whom held those positions during the period at issue.

The Company disputes and will vigorously defend itself against these claims through independent Canadian litigation counsel retained by the Company and the other defendants for this purpose. Due to the inherent uncertainties of litigation, it is not possible to predict the final outcome of the Ontario Action or determine the amount of any potential losses, if any.

In the event the Company incurs any liability in connection with the Ontario Action, it maintains insurance with respect thereto. While the Company believes that such insurance coverage is in an amount that would be sufficient to cover any amounts the Company may be required or determines to pay with respect thereto, there can be no assurance that such coverage will be adequate to do so, and, if so, any amounts not so covered would be required to be paid by the Company. The Company's ability to continue as a going concern will be impacted to the extent it is required to pay any amounts in connection with the Ontario Action.

If the Company is unable to continue as a going concern it may be forced to seek relief under applicable bankruptcy and insolvency legislation.

If the Company seeks relief under applicable bankruptcy and insolvency legislation, its business and operations will be subject to certain risks, including but not limited to, the following:

- An insolvency filing by or against the Company will cause an event of default under the Convertible Debenture (see Risk Factor below entitled "If an event of default occurs under the Convertible Debenture, CIC has the right to accelerate amounts owing thereunder" in this MD&A);
- An insolvency filing by or against the Company may adversely affect its business prospects, including its ability to continue to obtain and maintain the contracts necessary to operate its business on competitive terms;
- There can be no assurance as to the Company's ability to maintain or obtain sufficient financing sources for operations or to fund any reorganization plan and meet future obligations;
- There can be no assurance that the Company will be able to successfully develop, prosecute, confirm and consummate one or more plans of reorganization that are acceptable to the applicable courts and its creditors, equity holders and other parties in interest; and
- The value of the Common Shares could be reduced to zero as result of an insolvency filing.

14. RISK FACTORS continued

Risks Relating to the Company's Projects in Mongolia

In addition to the Tax Verdict and the Appeal Verdict, the Company is subject to continuing governmental, regulatory and internal investigations, the outcome of which is unclear at this time but could have a material adverse effect on the Company.

In addition to the Tax Verdict and the Appeal Verdict, the Company is subject to certain investigations referred to under the heading "REGULATORY ISSUES AND CONTINGENCIES – Regulatory Issues – Governmental and Regulatory Issues" in this MD&A, which could result in one or more of the 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 investigative actions 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 and the value of the Common Shares.

For a description of the Tax Verdict and the Appeal Verdict refer to "REGULATORY ISSUES AND CONTINGENCIES – Regulatory Issues – Governmental and Regulatory Issues" in this MD&A.

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

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

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

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

14. RISK FACTORS continued

Risks Relating to the Company's Projects in Mongolia continued

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

With the exception of an insolvency event, if an event of default occurs under the Convertible Debenture, and such event of default has not been cured or waived, the principal amount owing and all accrued and unpaid interest will become immediately due and payable upon notice to the Company by CIC which would have a material adverse effect on the business and operations of the Company.

If an insolvency event occurs under the Convertible Debenture, the principal amount owing and all accrued and unpaid interest will become immediately due and payable without the necessity for notice to the Company by CIC, which would have a material adverse effect on the business and operations of the Company.

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

The 2006 Minerals Law (as defined under the heading "DEFINTIONS AND OTHER INFORMATION – Defined Terms and Abbreviations" in the Annual Information Form), which preserves to a limited extent some of the substance of the former 1997 minerals legislation, was drafted with the assistance of legal experts in the area of mining legislation and was widely regarded as progressive, internally consistent and effective legislation. However, the 2006 Minerals Law has been subsequently amended and the potential for political interference has increased and the rights and security of title holders of mineral tenures in Mongolia has been weakened. Certain provisions of the 2006 Minerals Law are ambiguous and it is unclear how they will be interpreted and applied in practice. Examples of such provisions include those relating to the designation of a mineral deposit as a Mineral Deposit of Strategic Importance (as defined under the heading "DEFINTIONS AND OTHER INFORMATION – Defined Terms and Abbreviations" in the Annual Information Form).

In addition, the introduction of new Mongolian laws and regulations and the interpretation of existing ones may be subject to policy changes reflecting domestic political or social changes. For example, on July 16, 2009, the Parliament of Mongolia enacted the Mining Prohibition in Specified Areas Law (the "Specified Areas Law") that prohibits minerals exploration and mining in areas such as headwaters of rivers and lakes, forest areas as defined in the Law of Forests of Mongolia of May 17, 2012, as amended, and areas adjacent to rivers and lakes as defined in the Law of Mongolia on Water enacted on May 17, 2012, as amended.

Pursuant to the Specified Areas Law, the Government of Mongolia has defined the boundaries of certain areas in which exploration and mining is purportedly prohibited. A list of licences 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.

Portions of the mining licence in respect of the Ovoot Tolgoi Complex and the exploration licences pertaining to the Zag Suuj Deposit and the South Biluut and Jargalant Fields within the Soumber Deposit are included on the list of specified areas described in the Specified Areas Law.

In regard to the Ovoot Tolgoi Mining Licence, the potential area which may be affected is a relatively small area which represents approximately 3% of the entire area of the mining licence 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.

14. RISK FACTORS continued

Risks Relating to the Company's Projects in Mongolia continued

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

Activities historically carried out on the other licences 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 licences and the loss of any or all of these potentially affected properties would not materially and adversely affect the existing operations.

The Mining Prohibition in Specified Areas Law has not been adequately enforced to date mainly due to compensation issues due to the licence holders.

On February 18, 2015 the Parliament of Mongolia adopted an amendment to the Law on Implementation of the Specified Areas Law (the "Law on Implementation"). The amendment provides an opportunity for licence holders covered within the scope of application of the Specified Areas Law to continue their mining operations subject to advance placement of funds to cover 100% of the future environmental rehabilitation costs. A model contract and a specific Government regulation on this requirement is expected be adopted by the Government in the first half of 2015. The licence holder must also apply within 3 months after the amendment to the Law on Implementation comes into effect to obtain permission from MRAM to resume activities. Penalties for not acting in accordance with the Law on Implementation include the potential revocation of mining and exploration licences.

The Company will continue to monitor developments and will ensure that it follows the necessary steps in the Law on Implementation to secure its operations and licences and is fully compliant with Mongolian law.

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

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

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

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

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

14. RISK FACTORS continued

Risks Relating to the Company's Projects in Mongolia continued

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

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

Under the 2006 Minerals Law, the size of the Government of Mongolia's participation is determined largely by the level of state funding which has been provided for the exploration and development of any deposit, with the Government of Mongolia entitled to participate up to 50% in the event that there has been state funding of such deposit and up to 34% if there has not. However, the 2006 Minerals Law is very vague as to the details and method by which the Government of Mongolia will take its interest and the final arrangements in respect of the Government of Mongolia's interest in each Mineral Deposit of Strategic Importance, including the amount of compensation to be paid to the licence holder and the actual form of the Government of Mongolia's interest are subject to negotiation between the Government of Mongolia and the licence holder. As discussed in the section in the Annual Information Form entitled "Legislative Developments", on February 18, 2015, the Parliament of Mongolia adopted an amendment to the 2006 Minerals Law providing for a possibility for the Government to collect a special royalty on minerals deposit of strategic importance in lieu of holding an equity stake in such deposit.

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

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

14. RISK FACTORS continued

Risks Relating to the Company's Projects in Mongolia continued

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

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

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

Prior to October 3, 2013, the Company was subject to the Foreign Investment Law of Mongolia ("FIL") described in the Company's Management's Discussion and Analysis of Financial Condition and Results of Operation for the period ended December 31, 2012. The Company considers that this Risk Factor has been substantially mitigated following the repeal of the FIL and introduction of the Investment Law on October 3, 2013, which appears to provide greater certainty for foreign investment in Mongolia. However, that certainty remains subject to the inherent uncertainties of the legal system in Mongolia as described in the Risk Factor entitled the "Legislation in Mongolia may be subject to conflicting interpretations, which may have adverse consequences on the Company's business".

Risks relating to the Company's business and industry

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

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

The Company's projects are subject to both (i) technical risk in that they may not perform as designed, or (ii) operational redesign or modification as a result of the current evaluation of the projects (refer to "PROPERTIES – Operating Mines – Ovoot Tolgoi Mine" in this MD&A for more information on the current technical review being undertaken by the Company and the responsible QPs). Increased development costs, lower output or higher operating costs may all combine to make a project less profitable than expected at the time of the development decision. This would have a negative impact on the Company's business and results of operations. No assurance can be given that the Company would be adequately compensated by third party project design and construction companies (if not performed by the Company) in the event that a project did not meet its expected design specification.

14. RISK FACTORS continued

Risks relating to the Company's business and industry continued

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

The Ovoot Tolgoi Technical Report assumed that the Ejin Jinda wet wash plant at Ceke would process 1.5 million tonnes of coal in 2012. Construction of the wet wash plant was completed in 2012. The Ovoot Tolgoi Technical Report also assumes that the Ejin Jinda wet wash plant is expanded to process 7.0 million tonnes annually from mid-2014. The Company is currently cooperating with Ejin Jinda in studying the utilization of the wet washing facility. Any delay in expanding annual capacity to 7.0 million tonnes by mid-2014, would likely impact the project economics, as the coal would be sold as lower value coal. As of the date of the Annual Information Form, commercial operations of the Ejin Jinda wet wash plant have not commenced and to date no plans have been discussed with the Company for the expansion of the Ejin Jinda wet wash plant to the proposed 7.0 million tonne annual capacity.

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

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

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

The Company and the responsible QPs are currently engaged in a comprehensive review of the information upon which the mineral resource and reserve estimates for the Ovoot Tolgoi Technical Report have been based. This review is part of the normal re-optimization process generally adopted by mining companies experiencing significant changes in their economic environment. The review of the mine plan by the Company includes updates of the cash costs and cost profile of the operations, project development and production sequencing and forecasts. The Company and the responsible QPs are also reviewing the classification of a portion of the geology type at the Ovoot Tolgoi Mine, which may have a material impact on production levels as discussed under the heading "PROPERTIES – Operating Mines – Ovoot Tolgoi Mine" in this MD&A. In addition, the Company is reviewing and updating its mine design parameters, mine designs and project development schedule in order to reflect its production plan and the market conditions.

14. RISK FACTORS continued

Risks relating to the Company's business and industry continued

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

The review of the geology and mine plan for the Ovoot Tolgoi Complex has not yet been completed, nor has a new mine plan been presented to or been approved by the Board. As a result of the significant changes in some of the mining planning factors compared to those used for the Ovoot Tolgoi Technical Report, this review may result in material changes to the reserves for the Ovoot Tolgoi Complex. Some of these changes, such as an upgrading of some resources from the inferred category to the measured and indicated category in the Sunset pit area, a change to mine design with steeper pit walls resulting in less waste and a lower strip ratio and improved mining cash costs, simplified and lower cost coal processing and product marketing, and general cost reductions achieved by the Company in recent times, may result in an increase in reserves. However, other changes, such as the decline in coal prices in China, decreased mining quantities resulting from smaller pit dimensions as a result of changed mining parameters and coal prices, and the exclusion of coal identified in the previous studies as marginally economic due to coal price reductions, may result in a decrease in reserves.

Until the Company has completed this review and adopted a new mine plan, it is unable to conclude that a change in the coal reserve estimates has occurred compared to previous studies and it is also unable to conclude on the materiality of any such change for the Company. Upon the completion and adoption of a new mine plan, the Company intends to have all input parameters, procedures and forecasts fully verified and reviewed in accordance with NI 43-101. This may lead, if required, to the preparation of a new technical report containing updated coal reserves estimates for the Ovoot Tolgoi Complex.

As a result of this review, estimates of the Company's mineral reserves and resources may change significantly, and existing interpretations and deductions on which the current reserves and resources estimates are based may prove to be inaccurate. Any downward adjustments to the Company's mineral resource or reserve estimates resulting from this review could materially affect the Company's development and mining plans, which could materially and adversely affect its business and results of operations.

In addition to the aforementioned specific review in respect of the Ovoot Tolgoi Technical Report, the Company also notes that, in general, mineral resource and reserve estimates are always subject to change based on new information. Specifically, should the Company encounter mineralization different from that predicted by past drilling, sampling and similar examination, mineral resource and/or reserve estimates may have to be adjusted downward. In addition, the rank of coal ultimately mined may differ from that indicated by drilling results. There can be no assurance that coal recovered in laboratory tests will be duplicated under on-site conditions or in production-scale operations. In the event that the actual level of impurities is higher than expected or the coal mined is of a lower quality than expected, the demand for, and realizable price of, the Company's coal may decrease. Short term factors relating to reserves, such as the need for orderly development of coal seams or the processing of new or different quality coals, may also materially and adversely affect the Company's business and results of operations.

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

14. RISK FACTORS continued

Risks relating to the Company's business and industry continued

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

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

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

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

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

14. RISK FACTORS continued

Risks relating to the Company's business and industry continued

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

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

In addition, certain provisions of the Law on Land of Mongolia enacted on June 7, 2002, as amended (the "Land Law of Mongolia") and the 2006 Minerals Law provide for the revocation of previously granted land use rights, MELs or mining licences on the grounds that the affected area of land has been designated as "special needs" territory ("SNT"). The Land Law of Mongolia grants the discretion to declare an area of land for special needs purposes to local governing authorities and identifies various broad categories which qualify as special needs. The 2006 Minerals Law requires the local governing authority that designates an area of land as a special needs territory to compensate within one year the licence holder whose rights or licence status are affected. The failure to pay the compensation within the one year period would allow the licence holder to resume its operations. If any of the Company's land use rights, MELs or mining licences in Mongolia are revoked because the underlying land is declared as special needs territory, there is no assurance that the Company will receive adequate compensation and its business and results of operation might be adversely and materially affected.

On February 13, 2015 a special meeting of the Citizens' Representatives Khural ("CRK") of Umnugobi Province was held. The CRK resolved to establish an SNT over an area covering approximately 233,600 ha in Gurvantes and Noyon Soums of Umnugobi Province. The resolution closely follows the resolutions adopted previously by the provincial CRK on the same issue, albeit the land area of the SNT has been reduced compared to previous resolutions.

The new SNT overlaps with the following licences held by the Company in the area:

- MEL XV-009443 at the south-east edge point of the licence; and
- The Soumber Mining Licence (as defined under the heading "MATERIAL PROPERTIES – Soumber Deposit – Property Description and Location" in the Annual Information Form).

The CRK has previously adopted similar resolutions purporting to take the areas covered by various licences of the Company to establish a new SNT, including MELs XV-009443X and MEL XV-009449, as well as the Soumber Mining Licence. The Company successfully challenged these previous resolutions though administrative court process and obtained court verdicts invalidating such resolutions. The Company is planning to yet again challenge the newest CRK resolution.

The Company is confident of a positive outcome in its challenge of this new CRK resolution; however, if the resolution is upheld by the court, there is no assurance that the Company will receive adequate compensation and its business and results of operation might be adversely and materially affected.

14. RISK FACTORS continued

Risks relating to the Company's business and industry continued

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

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

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

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

If realized coal prices are below the full cost of production of any of the Company's future mining operations and remain at such a level for any sustained period, the Company could experience increased losses and may decide to discontinue operations, which could require the Company to incur closure costs and result in further reduced revenues.

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

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

14. RISK FACTORS continued

Risks relating to the Company's business and industry continued

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

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

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

In September 2014, a new paved highway from the Ovoot Tolgoi Complex to the Shivee Khuren Border Crossing was opened for limited use. This highway, which the Company has an indirect 40% shareholding, when fully operational on a commercial scale, is expected to significantly increase the safety of coal transportation, reduce environmental impacts and improve efficiency and capacity of coal transportation. The commercial operation of this highway has been delayed and is currently expected to commence in the second quarter of 2015. The paved highway is expected to have a carrying capacity in excess of 20 million tonnes of coal per year.

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

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

14. RISK FACTORS continued

Risks relating to the Company's business and industry continued

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

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

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

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

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

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

14. RISK FACTORS continued

Risks relating to the Company's business and industry continued

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

Until the successful implementation of the Proposed Funding Plan (of which there can be no assurance), the Company will continue to depend on a relatively small number of customers. The incremental cost of transporting coal products from the Ovoot Tolgoi Mine and its other coal projects over long distances effectively limits the Company's potential customer base to a relatively proximate geographical area. This market has also been price sensitive and significant price volatility impacts contract performance.

Additionally, the Company has been selling its coal products since 2008. The Company had six active customers with the largest customer representing approximately 34%, the second largest customer representing approximately 29%, the third largest customer representing approximately 27% and the remaining customers accounting for 10% of the Company's total sales for the year ended December 31, 2014. In order to mitigate this risk, the Company developed the Proposed Funding Plan collaboratively with Novel Sunrise in order to expand its existing customer base.

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

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

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

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

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

14. RISK FACTORS continued

Risks relating to the Company's business and industry continued

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

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

Foreign currency fluctuations could affect expenses and any future earnings.

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

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

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

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

14. RISK FACTORS continued

Risks relating to the Company's business and industry continued

The interests of the Company's principal stakeholders, TRQ, CIC and Novel Sunrise, may differ from those of the other stakeholders.

As of March 30, 2015, Turquoise Hill and CIC (also the Company's largest creditor by virtue of the Convertible Debenture) hold approximately 48% and 17% of the Common Shares, respectively. If the Novel SPA closes (i) Novel Sunrise will acquire Common Shares from TR and (ii) pursuant to the terms of the Novel Private Placement, the Mandatory Convertible Units (as defined under the heading "MATERIAL CONTRACTS – Novel Private Placement" in the Annual Information Form) owned by Novel Sunrise will convert to Common Shares and Novel Sunrise will subscribe for additional Common Shares, such that Novel Sunrise will own approximately 29% of the Common Shares in the aggregate. The interests of each of these stakeholders may conflict with the interests of other Shareholders and there is no assurance that any of these stakeholders will vote its Common Shares in a way that benefits minority Shareholders. While no Shareholder has the ability to elect a majority of the Board unilaterally, each of CIC and Novel Sunrise have been granted contractual director appointment rights. In addition, the Company believes that third parties may be discouraged from making a tender offer or bid to acquire the Company because of this concentration of ownership of Common Shares among these three parties.

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

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

Future stock market conditions may change.

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

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

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

15. Outlook

Coal markets continued to deteriorate in 2014. China, the main market for Mongolian coal producers, suffered from overcapacity coupled with decreasing demand. China's import of thermal and coking coal fell by 1.2% and 17.2% respectively year-on-year.

Coal prices in China, which were already under pressure from excess supply, continued to decline as demand fell in 2014. Prices stabilized in the fourth quarter of 2014 after hitting seven year lows in the third quarter of 2014. However, prices remain well below the levels achieved over the last three years and the Mongolian coal industry faced strong competition from seaborne and domestic Chinese coal producers.

The Chinese government introduced quality standards for commercial coal in September 2014. These standards were implemented on January 1, 2015 and to both domestic and import coal. Coal import tariffs were also introduced by the Chinese government, effective as of October 15, 2014. Import tariff on coking coal is 3% and thermal coal is 6%. These import tariffs put Mongolian coal exporters at a disadvantage relative to coal producers from certain other countries as some of the largest coal exporters into China are exempt from the tariffs due to country- to-country trade agreements.

The outlook for Mongolian coal exports remains dependent on the Chinese economy. Demand in early 2015 has been seasonally weak with Chinese coal imports hitting a 43-month low in January 2015. Prices declined again after rising slightly in the fourth quarter of 2014.

The Company anticipates that coal prices in China will remain under pressure in 2015, which will continue to impact the Company's margins and liquidity. The Company continues to strive for further cost reductions and where possible will delay expenditures. In addition, the Company entered into the transaction with Novel Sunrise as a new significant shareholder and strategic partner intending to bring its operational and marketing expertise to the Company. Novel Sunrise has agreed to assist the Company in implementing a funding plan intended to improve cash flow for the Company and support its business strategy and operations in a difficult market, with the goal of positioning the Company with a strong future as a coal producer. The proposed plan includes introducing potential customers in China to the Company to allow the Company to expand its customer base further inland in China, and helping the Company to secure longer-term coal offtake arrangements, thereby allowing the Company to ramp up production to capacity. Novel Sunrise also intends to help the Company to establish relationships with commercial banks in China and Hong Kong to help the Company to secure short term bridge loans, trading credit facilities and other types of financing.

15. Outlook continued

The Company's consolidated financial statements have been prepared on a going concern basis which assumes that the Company will continue operating until at least December 31, 2015 and will be able to realize its assets and discharge its liabilities in the normal course of operations as they come due. While the Company is actively seeking additional sources of financing to continue operating and meet its objectives, there can be no assurance that such financing will be available on terms acceptable to the Company. If for any reason, the Company is unable to implement the funding plan it has developed with Novel Sunrise or is not able to secure additional sources of financing to continue as a going concern, adjustments to the amounts and classifications of assets and liabilities in the Company's consolidated financial statements may be required and such adjustments could be material.

A continued delay in securing additional financing could ultimately result in an event of default of the Convertible Debenture, which if not cured within applicable cure periods in accordance with the terms of such debenture, may result in the principal amount owing and all accrued and unpaid interest becoming immediately due and payable upon notice to the Company by CIC.

The Company remains well positioned in the market, with a number of key competitive strengths, including:

- **Strategic location** – The Ovoot Tolgoi Mine is located approximately 40km from China, which represents the main coal market. The Company has an infrastructure advantage, being approximately 50km from a major Chinese coal distribution terminal with rail connections to key coal markets in China.
- **Large resource base** – The Company's aggregate coal resources include measured and indicated resources of 497 million tonnes and inferred resources of 293 million tonnes. These numbers have been aggregated from the Ovoot Tolgoi Technical Report, the Soumber Technical Report and the Zag Suuj Technical Report. The Measured and Indicated Coal Resources are inclusive of those Coal Resources modified to produce the Coal Reserves.
- **Several growth options** – The Company has several growth options including an anticipated increase to 9 million tonnes annual run-of-mine capacity at the Ovoot Tolgoi Mine as well as greenfield options with the Soumber Deposit and Zag Suuj Deposit, located approximately 20km east and approximately 150km east of the Ovoot Tolgoi Mine, respectively.
- **Flexible product offering** – Most of the Company's coal resources have coking properties, including a mixture of semi-soft coking coals and hard coking coals. The Company is currently studying options to supply washed coal to the market to further improve its market position and access to end customers.

15. Outlook continued

Objectives

The Company's objectives for 2015 and the medium term are as follows.

- Execute step change improvement in Company's sales, marketing and logistics capabilities and expand the Company's customer base further inland in China – Subject to available financial resources and in cooperation with the Company's new strategic partner, Novel Sunrise, implement an effective business structure and production profile that is capable of delivering a sustainable and profitable product mix to the Chinese market.
- Drive operational excellence – The Company is focused on further improving productivity and operational efficiency in delivering production to meet market requirements.
- Progress growth options – Subject to available financial resources, the Company plans to further the development of the Soumber Deposit, while staying compliant with all government requirements in relation to its licenses and agreements.
- Operate in a socially responsible manner – The Company is focused on maintaining the highest standards in health, safety and environmental performance.
- Enhance the Company's reputation – The Company is committed to contributing to the long term development and prosperity of Mongolia and its local communities.

March 30, 2015


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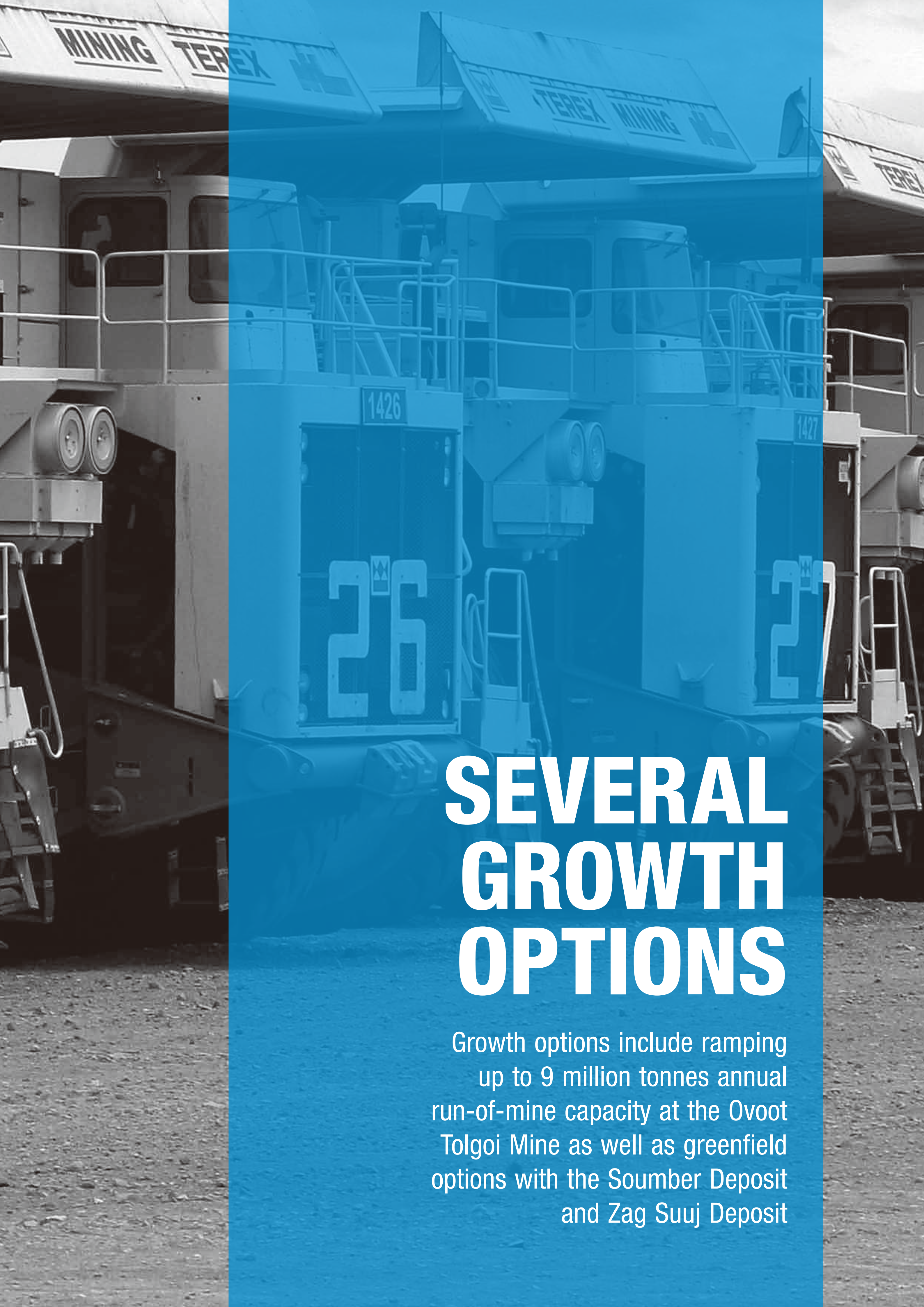

SEVERAL GROWTH OPTIONS

Growth options include ramping up to 9 million tonnes annual run-of-mine capacity at the Ovoot Tolgoi Mine as well as greenfield options with the Soumber Deposit and Zag Suuj Deposit

CONSOLIDATED FINANCIAL STATEMENTS

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INDEPENDENT AUDITOR'S REPORT

To the Shareholders of SouthGobi Resources Ltd.

We have audited the accompanying consolidated financial statements of SouthGobi Resources Ltd., which comprise the consolidated statements of financial position as at December 31, 2014 and December 31, 2013 and the consolidated statements of comprehensive income, changes in equity and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditor's responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of SouthGobi Resources Ltd. as at December 31, 2014 and December 31, 2013 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Emphasis of matter

Without qualifying our opinion, we draw attention to Note 1 in the consolidated financial statements which describes matters and conditions that indicate the existence of a material uncertainty that casts significant doubt about the Company's ability to continue as a going concern.

signed "PricewaterhouseCoopers LLP"
Chartered Accountants
Vancouver, Canada
March 30, 2015

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

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

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

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

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Expressed in thousands of U.S. Dollars)

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

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

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

APPROVED BY THE BOARD:

"André Deepwell"

Director

"Pierre Lebel"

Director

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

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

	Number of shares		Common shares		Share option reserve		Investment revaluation reserve		Accumulated deficit		Total
Balances, January 1, 2013	181,928	$	1,059,710	$	51,303	$	–	$	(507,030)	$	603,983
Shares issued for:											
Interest settlement on convertible debenture	5,310		8,000		–		–		–		8,000
Employee share purchase plan	71		129		–		–		–		129
Share-based compensation charged to operations	–		–		(105)		–		–		(105)
Net loss for the year	–		–		–		–		(237,464)		(237,464)
Change in value of available-for-sale financial asset, net of tax	–		–		–		514		–		514
Balances, December 31, 2013	187,309	$	1,067,839	$	51,198	$	514	$	(744,494)	$	375,057
Balances, January 1, 2014	**187,309**	**$**	**1,067,839**	**$**	**51,198**	**$**	**514**	**$**	**(744,494)**	**$**	**375,057**
Shares issued for:											
Interest settlement on convertible debenture	**7,068**		**4,000**		**–**		**–**		**–**		**4,000**
Private placement (net proceeds)	**24,361**		**8,568**								**8,568**
Employee share purchase plan	**14**		**10**		**–**		**–**		**–**		**10**
Share-based compensation charged to operations	**–**		**–**		**843**		**–**		**–**		**843**
Net loss for the year	**–**		**–**		**–**		**–**		**(103,683)**		**(103,683)**
Change in value of available-for-sale financial asset, net of tax	**–**		**–**		**–**		**(514)**		**–**		**(514)**
Balances, December 31, 2014	**218,752**	**$**	**1,080,417**	**$**	**52,041**	**$**	**–**	**$**	**(848,177)**	**$**	**284,281**

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Expressed in thousands of U.S. Dollars)

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

Supplemental cash flow information (Note 28)

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

1. Corporate information and going concern

SouthGobi Resources Ltd. is a publicly listed company incorporated in Canada with limited liability under the legislation of the Province of British Columbia and its shares are listed on the Toronto Stock Exchange (Symbol: SGQ) and Hong Kong Stock Exchange (Symbol: 1878). The company, together with its subsidiaries (collectively referred to as the "Company"), is an integrated coal mining, development and exploration company. At December 31, 2014, Turquoise Hill Resources Ltd. ("Turquoise Hill") owned approximately 48% of the outstanding common shares of the Company (Note 27). Turquoise Hill is controlled by Rio Tinto plc ("Rio Tinto").

The Company owns the following significant coal projects in Mongolia: the Ovoot Tolgoi open pit producing coal mine ("Ovoot Tolgoi Mine") and the following significant development projects, the Soumber Deposit, the Zag Suuj Deposit and the Ovoot Tolgoi Underground Deposit. These projects are located in the Umnugobi Aimag (South Gobi Province) of Mongolia, within 150 kilometers of each other and in close proximity to the Mongolia-China border. The Company owns a 100% interest in these coal projects. The head office, principal address and registered and records office of the Company is located at 354 – 200 Granville Street, Vancouver, British Columbia, Canada, V6C 1S4.

Going concern assumption

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

The Company's consolidated financial statements have been prepared on a going concern basis which assumes that the Company will continue operating until at least December 31, 2015 and will be able to realize its assets and discharge its liabilities in the normal course of operations as they come due. However, in order to continue as a going concern, the Company must generate sufficient operating cash flows, secure additional capital or otherwise pursue a strategic restructuring, refinancing or other transaction to provide it with additional liquidity. If it fails to do so, or is unable to secure additional capital or otherwise restructure or refinance its business in order to address its cash requirements through December 31, 2015, then the Company is unlikely to have sufficient capital resources or cash flows from mining operations in order to satisfy its ongoing obligations and future contractual commitments, including cash interest payments due on the CIC convertible debenture. As a result, it may not be able to continue as a going concern.

1. Corporate information and going concern continued

If for any reason, the Company is unable to secure the additional sources of financing and continue as a going concern, then this could result in adjustments to the amounts and classifications of assets and liabilities in the Company's consolidated financial statements and such adjustments could be material.

While the Company intends to secure additional sources of financing as soon as possible, a continued delay in securing additional financing could ultimately result in an event of default of the $250,000 CIC convertible debenture, which if not cured within applicable cure periods in accordance with the terms of such debenture, may result in the principal amount owing and all accrued and unpaid interest becoming immediately due and payable upon notice to the Company by CIC.

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

2. Basis of preparation

2.1 Statement of compliance

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

The consolidated financial statements of the Company for the year ended December 31, 2014 were approved and authorized for issue by the Board of Directors of the Company on March 30, 2015.

2.2 Basis of presentation

The consolidated financial statements have been prepared on a historical cost basis except for certain financial assets and financial liabilities which are measured at fair value. The Company's financial instruments are further disclosed in Note 26.

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

2.3 Adoption of new and revised standards and interpretations

The Company has adopted the new and revised standards and interpretations issued by the IASB listed below effective January 1, 2014. These changes were made in accordance with the transitional provisions outlined in the respective standards and interpretations.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

2. Basis of preparation continued

IFRIC 21 Levies

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

Annual Improvements 2010-2012 Cycle

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

2.4 Standards issued but not yet effective

The standards and interpretations that are issued up to the date of issuance of the Company's financial statements, but were not effective during the year ended December 31, 2014, are disclosed below. The Company intends to adopt these standards, if applicable, when they become effective.

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

(i) Effective for annual periods beginning on or after July 1, 2014

(ii) Effective for annual periods beginning on or after January 1, 2016

(iii) Effective for annual periods beginning on or after January 1, 2017

(iv) Effective for an entity that first adopts IFRSs for its annual financial statements beginning on or after January 1, 2016 and therefore is not applicable to the Company

2. Basis of preparation continued

2.4 Standards issued but not yet effective continued

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

IFRS 9 Financial instruments

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

IFRS 15 Revenue from Contracts with Customers

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

3. Summary of significant accounting policies

3.1 Basis of consolidation

The consolidated financial statements include the financial statements of SouthGobi Resources Ltd. and its controlled subsidiaries and investees.

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

The Company controls an entity when the Company is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

3. Summary of significant accounting policies continued

3.2 Foreign currencies

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

3.3 Borrowing costs

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

3.4 Inventories

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

Materials and supplies inventory consists of consumable parts and supplies which are valued at the lower of weighted average cost and net realizable value, less allowances for obsolescence. Replacement cost is used as the best available measure of net realizable value. Supplies used in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost.

3.5 Property, plant and equipment

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

Initial recognition

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

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

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

3. Summary of significant accounting policies continued

3.5 Property, plant and equipment continued

Depreciation and depletion

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

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

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

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

3.6 Mineral properties

Evaluation and exploration expenses

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

Commencement of commercial production

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

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

3.7 Development and production stripping costs

Once a property is determined to have economically recoverable reserves, the Company's subsequent exploration and evaluation and development expenses are capitalized as mineral property costs within property, plant and equipment.

Production stripping activity assets are recognized when the following three criteria are met:

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

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

3. Summary of significant accounting policies continued

3.8 Decommissioning, restoration and similar liabilities

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

3.9 Joint arrangements

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

3.10 Share-based payments

Share-based payment transactions

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

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

Equity-settled transactions

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

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

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

3. Summary of significant accounting policies continued

3.11 Earnings per share

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

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

3.12 Taxation

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

Current income tax

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

Deferred income tax

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

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

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

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

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

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

3. Summary of significant accounting policies continued

3.12 Taxation continued

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

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

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

3.13 Financial assets

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

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

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

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

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

3.14 Financial liabilities

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

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

3. Summary of significant accounting policies continued

3.14 Financial liabilities continued

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

3.15 Impairment of financial assets

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

Assets carried at amortized cost

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

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

Available-for-sale

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

3.16 Derecognition of financial assets and financial liabilities

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

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

3. Summary of significant accounting policies continued

3.17 Impairment of non-financial assets

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

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

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

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

3.18 Cash and cash equivalents

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

3.19 Revenue recognition

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

Revenue from the sale of coal is recognized when the significant risks and rewards of ownership and effective control of the coal are transferred to the buyer and the selling prices are known or can be reasonably estimated.

3.20 Provisions

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

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

3. Summary of significant accounting policies continued

3.21 Related party transactions

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

3.22 Significant accounting judgments and estimates

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

Liquidity and the going concern assumption

In the determination of the Company's ability to meet its ongoing obligations and future contractual commitments, management relies on the Company's planning, budgeting and forecasting process to help determine the funds required to support the Company's normal operations on an ongoing basis and its expansionary plans. The key inputs used by the Company in this process include forecasted capital deployment, results from operations, results from the exploration and development of its properties and general industry conditions.

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

The Company's consolidated financial statements have been prepared on a going concern basis which assumes that the Company will continue operating until at least December 31, 2015 and will be able to realize its assets and discharge its liabilities in the normal course of operations as they come due; however, in order to continue as a going concern, the Company must generate sufficient operating cash flows, secure additional capital or otherwise pursue a strategic restructuring, refinancing or other transaction to provide it with additional liquidity. If it fails to do so, or is unable to secure additional capital or otherwise restructure or refinance its business in order to address its cash requirements through December 31, 2015, then the Company is unlikely to have sufficient capital resources or cash flows from mining operations in order to satisfy its ongoing obligations and future contractual commitments, including cash interest payments due on the CIC convertible debenture. As a result, it may not be able to continue as a going concern.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

3. Summary of significant accounting policies continued

3.22 Significant accounting judgments and estimates continued

Liquidity and the going concern assumption continued

If for any reason, the Company is unable to secure the additional sources of financing and continue as a going concern, then this could result in adjustments to the amounts and classifications of assets and liabilities in the Company's consolidated financial statements and such adjustments could be material.

While the Company intends to secure additional sources of financing as soon as possible, a continued delay in securing additional financing could ultimately result in an event of default of the $250,000 CIC convertible debenture, which if not cured within applicable cure periods in accordance with the terms of such debenture, may result in the principal amount owing and all accrued and unpaid interest becoming immediately due and payable upon notice to the Company by CIC.

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

Valuation of embedded derivatives

The embedded derivatives in the Company's convertible debenture are valued using a Monte Carlo simulation valuation model. A Monte Carlo simulation model is a valuation model that relies on random sampling and is often used when modeling systems with a large number of inputs and where there is significant uncertainty in the future value of inputs and where the movement of the inputs can be independent of each other.

The key inputs used by the Company in its Monte Carlo simulation are further disclosed in Note 20.2 and Note 20.3. Changes in the inputs to the valuation model could impact the carrying value of the embedded derivatives in the convertible debenture and the amount of unrealized gains or losses recognized in profit or loss. The carrying value of the embedded derivatives in the Company's convertible debenture as at December 31, 2014 was a liability of $1,834 (December 31, 2013: $3,395).

Review of carrying value of assets and impairment charges

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

Prepaid toll washing fees

Refer to Note 14 and Note 30.5 for further analysis of the $3,405 impairment loss recorded in 2014 on the prepaid toll washing fees which are part of the contract with Ejinaqi Jinda Coal Industry Co. Ltd ("Ejin Jinda").

3. Summary of significant accounting policies continued

3.22 Significant accounting judgments and estimates continued

Review of carrying value of assets and impairment charges continued

Ovoot Tolgoi Mine cash generating unit

The Company determined that an indicator of impairment existed for its Ovoot Tolgoi Mine cash generating unit as at December 31, 2014. The impairment indicator was the continued weakness in the Company's share price during the year ended December 31, 2014 and the fact that the market capitalization of the Company, as at December 31, 2014, was less than the carrying value of its net assets.

Therefore, the Company conducted an impairment test whereby the carrying value of the Company's Ovoot Tolgoi Mine cash generating unit was compared to its "value in use" using a discounted future cash flow valuation model. The Company's cash flow valuation model has been updated to take into consideration the latest available information to the Company, including but not limited to, sales price, sales volumes and washing assumptions, operating cost assumptions and life of mine coal production assumptions as at December 31, 2014. The Company's Ovoot Tolgoi Mine cash generating unit carrying value was $358,600 as at December 31, 2014.

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

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

Key sensitivities in the valuation model are as follows:

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

The impairment analysis did not result in the identification of an impairment loss and no charge was required as at December 31, 2014. A decline of more than 1% in the long term price estimates, an increase of more than 1% in the pre-tax discount rate or an increase of more than 2% in the cash mining cost estimates may trigger an impairment charge on the cash generating unit. The Company believes that the estimates and assumptions incorporated in the impairment analysis are reasonable; however, the estimates and assumptions are subject to significant uncertainties and judgments.

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

3. Summary of significant accounting policies continued

3.22 Significant accounting judgments and estimates continued

Review of carrying value of assets and impairment charges continued

Investment in RDCC LLC

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

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

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

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

Key sensitivities in the valuation model are as follows:

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

The impairment analysis did not result in the identification of an impairment loss and no charge was required as at December 31, 2014. The Company believes that the estimates and assumptions incorporated in the impairment analysis are reasonable; however, the estimates and assumptions are subject to significant uncertainties and judgments.

Estimated recoverable reserves

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

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

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

3. Summary of significant accounting policies continued

3.22 Significant accounting judgments and estimates continued

Useful lives and depreciation rates for property, plant and equipment

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

Income taxes and recoverability of deferred tax assets

Actual amounts of income tax expense are not final until tax returns are filed and accepted by the taxation authorities. Therefore, profit or loss in future reporting periods will be affected by the amount that income tax expense estimates differ from the final tax returns. Judgment is required in determining whether deferred tax assets are recognized on the statement of financial position. Deferred tax assets, including those arising from unutilized tax losses, require management of the Company to assess the likelihood that the Company will generate sufficient taxable profit in future periods in order to utilize recognized deferred tax assets. Estimates of future taxable profit are based on forecast cash flows from operations and the application of existing tax laws in each jurisdiction. To the extent that future cash flows and taxable profit differ from estimates, the ability of the Company to realize the deferred tax assets recorded on the statement of financial position could be impacted. The carrying value of the Company's deferred income tax assets as at December 31, 2014 was nil (December 31, 2013: nil).

4. Segmented information

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

During the year ended December 31, 2014, the Mongolian Coal Division had 6 active customers with the largest customer accounting for 34% of revenues, the second largest customer accounting for 29% of revenue, the third largest customer accounting for 27% of revenue and the other customers accounting for the remaining 10% of revenue.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

4. Segmented information continued

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

	Mongolian Coal Division	Unallocated(i)	Consolidated Total
Segment assets			
As at December 31, 2014	$ **411,816**	$ **4,323**	$ **416,139**
As at December 31, 2013	490,949	15,257	506,206
Segment liabilities			
As at December 31, 2014	$ **22,770**	$ **109,088**	$ **131,858**
As at December 31, 2013	25,393	105,756	131,149
Segment loss			
For the year ended December 31, 2014	$ **(76,515)**	$ **(27,168)**	$ **(103,683)**
For the year ended December 31, 2013	(199,248)	(38,216)	(237,464)
Segment revenues			
For the year ended December 31, 2014	$ **24,494**	$ **–**	$ **24,494**
For the year ended December 31, 2013	58,636	–	58,636
Impairment charge on assets (ii)			
For the year ended December 31, 2014	$ **32,464**	$ **1,766**	$ **34,230**
For the year ended December 31, 2013	138,718	3,067	141,785

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

(ii) The impairment charge on assets for the year ended December 31, 2014 and year ended December 31, 2013 relates to trade and other receivables (Note 12), inventories (Note 13), prepaid expenses and deposits (Note 14), property, plant and equipment (Note 15) and investments (Note 16).

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

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

5. Cost of sales

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

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

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

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

5. Cost of sales continued

The Company's mining activities remained fully curtailed from January 1, 2013 until March 22, 2013, when the Company recommenced mining activities at the Ovoot Tolgoi Mine. The 2013 idled mine asset depreciation expense relates to the Company's idled plant and equipment during the curtailment of its mining activities. The 2014 idled mine asset depreciation expense relates to the Company's idled plant and equipment as the production plan during the year ended December 31, 2014 did not fully utilize the Company's existing mining fleet. In Mid-June, the Company placed approximately half of its workforce on furlough and reduced its mining activities accordingly. The furlough is anticipated to remain in place subject to market conditions.

6. Other operating expenses

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

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

7. Administration expenses

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

	Year ended December 31, 2014	2013
Corporate administration	$ 2,591	$ 3,269
Professional fees	2,680	8,252
Salaries and benefits	2,955	3,748
Share-based compensation expense (Note 23)	590	167
Depreciation	128	193
Administration expenses	**$ 8,944**	$ 15,629

8. Evaluation and exploration expenses

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

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

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

9. Finance costs and income

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

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

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

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

10. Taxes

10.1 Income tax recognized in profit or loss

The Canadian statutory tax rate increased to 26% due to legislative changes relating to British Columbia provincial tax (2013: 25.75%). A reconciliation between the Company's tax expense and the product of the Company's loss before tax multiplied by the Company's domestic tax rate is as follows:

	Year ended December 31, 2014	2013
Loss before tax	$ (103,097)	$ 212,478
Statutory tax rate	26.00%	25.75%
Income tax recovery based on combined Canadian federal and provincial statutory rates	(26,805)	(54,713)
Deduct:		
Lower effective tax rate in foreign jurisdictions	920	1,467
Tax effect of tax losses and temporary differences not recognized	18,199	59,878
Non-deductible expenses	8,272	18,354
Income tax expenses	$ 586	$ 24,986

10.2 Deferred tax balances

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

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

(i) Deferred income tax expense for the year ended December 31 2013 includes a $17,487 expense related to the derecognition of deferred tax assets.

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

10. Taxes continued

10.3 Unrecognized deductible temporary differences and unused tax losses

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

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

10.4 Expiry dates

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

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

11. Loss per share

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

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

Potentially dilutive items not included in the calculation of diluted loss per share for the year ended December 31, 2014 include the convertible debenture (Note 20) and stock options (Note 23) that were anti-dilutive.

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

12. Trade and other receivables

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

	As at December 31 2014	2013
Trade receivables	**$ –**	$ 1,818
Other receivables	**462**	760
Total trade and other receivables	**$ 462**	$ 2,578

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

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

Included in trade and other receivables are amounts due from related parties which are further disclosed in Note 27. The amounts due from related parties are unsecured, interest free and repayable upon written notice from the Company.

Trade receivables are normally due within 30 days from the date of billing. Customers with balances that are more than 30 days past due are normally requested to settle all outstanding balances before any further credit is granted.

For the year ended December 31, 2014, the Company recorded a $567 loss provision on its trade and other receivables in other operating expenses (2013: $200). The Company anticipates full recovery of its remaining outstanding trade and other receivables; therefore, no further loss provisions have been recorded in respect of the Company's trade and other receivables.

13. Inventories

The Company's inventories consist of the following amounts:

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

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

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

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

14. Prepaid expenses and deposits

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

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

14.1 Ejin Jinda toll coal washing prepayment

During the year ended December 31, 2011, the Company entered into an agreement with Ejin Jinda, a subsidiary of China Mongolia Coal Co. Ltd., to toll wash coal from the Ovoot Tolgoi Mine. The agreement covered a period of 5-years from commencement of coal washing and provided for an annual wet washing capacity and usage by the Company of approximately 3.5 million tonnes of input raw coal.

Commercial operations at the wet washing facility have not commenced. The Company identified the results of a trial sample from the wet washing facility and the delay in starting the commercial operations at the wet washing facility as indicators of impairment for the prepaid toll washing fees which are part of the contract with Ejin Jinda. Based on updated estimates and assumptions related to wash yields from the facility, a further impairment loss of $3,405 was recorded in other operating expenses during the year ended December 31, 2014 (2013: $30,151) to fully provide against the initial prepayment of $33,556.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

15. Property, plant and equipment

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

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

	Mobile equipment	Other operating equipment	Buildings and roads	Mineral properties	Construction in progress	Total
Cost						
As at December 31, 2012	$ 366,159	$ 28,043	$ 69,922	$ 116,084	$ 55,912	$ 636,120
Additions	1,162	266	2,129	10,984	122	14,663
Disposals	(3,632)	(507)	–	–	–	(4,139)
Reclassifications	–	548	163	–	(711)	–
As at December 31, 2013	$ 363,689	$ 28,350	$ 72,214	$ 127,068	$ 55,323	$ 646,644
Accumulated depreciation and impairment charges						
As at December 31, 2012	$ (93,519)	$ (7,359)	$ (9,299)	$ (4,470)	$ –	$ (114,647)
Charge for the year	(39,908)	(4,581)	(6,565)	(10,420)	–	(61,474)
Impairment charges	(6,267)	(5,765)	(11,590)	–	(49,047)	(72,669)
Eliminated on disposals	1,067	474	–	–	–	1,541
As at December 31, 2013	$ (138,627)	$ (17,231)	$ (27,454)	$ (14,890)	$ (49,047)	$ (247,249)
Carrying amount						
As at December 31, 2012	$ 272,640	$ 20,684	$ 60,623	$ 111,614	$ 55,912	$ 521,473
As at December 31, 2013	$ 225,062	$ 11,119	$ 44,760	$ 112,178	$ 6,276	$ 399,395

15.1 Prepayments on property, plant and equipment

As at December 31, 2014, the cost of the Company's property, plant and equipment includes $28,232 of prepayments to vendors (December 31, 2013: $41,240). The prepayments primarily relate to ordered but not yet delivered mobile equipment or mobile equipment delivered to the location of its intended use but not yet commissioned.

15.2 Impairment charges

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

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

16. Investments

The Company's investments consist of the following amounts:

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

16.1 Investment in Kangaroo Resources Limited

Kangaroo Resources Limited ("Kangaroo") is a company listed on the Australian Securities Exchange. Kangaroo's primary focus is its coal projects in Indonesia. The Company classified its investment in Kangaroo as a FVTPL financial asset with any change in value being recognized in profit or loss. During the year ended December 31, 2014, the Company disposed of its remaining 17,764 shares of Kangaroo for gross proceeds of $166 and realized a loss of $55 (2013: disposed of 22,236 shares for gross proceeds of $486 and realized a loss of $91).

16.2 Investment in Aspire Mining Limited

Aspire Mining Limited ("Aspire") is a company listed on the Australian Securities Exchange. Aspire's primary focus is its mineral exploration and mining licenses in Mongolia, particularly those pertaining to the Ovoot Coking Coal Project. The Company classified its investment in Aspire as an available-for-sale financial asset. During the year ended December 31, 2014, the Company disposed of all 123,498 shares it held in Aspire for gross proceeds of $2,791 and realized a loss of $1,104 (2013: nil).

16.3 Investment in RDCC LLC

The Company has a 40% interest in RDCC LLC, a joint venture. RDCC LLC has a concession agreement with the State Property Committee of Mongolia to construct a paved highway from the Company's Ovoot Tolgoi Mine to the Mongolia-China border. The concession agreement is structured as a 17-year build, operate and transfer agreement. The construction was completed in 2014 and the operation is expected to commence in the second quarter of 2015.

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

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

	Year ended December 31,	
	2014	2013
Balance, beginning of period	**$ 24,205**	$ 13,902
Funds advanced	**2,470**	10,356
Share of losses of joint venture	**(101)**	(53)
Balance, end of period	**$ 26,574**	$ 24,205

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

16. Investments continued

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

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

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

17. Trade and other payables

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

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

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

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

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

18. Deferred revenue

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

19. Interest-bearing borrowing

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

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

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

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

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

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

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

20. Convertible debenture

20.1 Key commercial terms

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

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

The key commercial terms of the financing include:

- Interest – 8% per annum (6.4% payable semi-annually in cash and 1.6% payable annually in the Company's common shares, where the number of shares to be issued is calculated based on the 50-day volume-weighted average price ("VWAP")).
- Term – Maximum of 30 years.
- Security – First charge over the Company's assets, including shares of its material subsidiaries. An event of default on the convertible debenture can be triggered as a result of certain encumbrances on the Company's assets (Note 30.3).
- Conversion price – The conversion price is set as the lower of Cdn$11.88 or the 50-day VWAP at the date of conversion, with a floor price of Cdn$8.88 per share.
- CIC's conversion right – CIC has the right to convert the convertible debenture, in whole or in part, into common shares twelve months after the date of issue.
- Company's normal conversion right – After sixty months from the issuance date, and when the conversion price is greater than Cdn$10.66, the Company is entitled to force conversion of the outstanding convertible debenture, in whole or in part, into common shares at the conversion price.
- Representation on the Company's Board – While the convertible debenture is outstanding, or while CIC has a minimum 15% direct or indirect stake in the Company, CIC has the right to nominate one director to the Company's Board of Directors. The Company currently has nine Board of Directors members of which none were elected by CIC.
- Voting restriction – CIC has agreed that it will not have any voting rights in the Company beyond 29.9% if CIC ever acquires ownership of such a shareholder stake.
- Pre-emption rights – While the convertible debenture is outstanding, or while CIC has a 15% direct or indirect stake in the Company, CIC has certain pre-emption rights on a pro-rata basis to subscribe for any new shares to be allotted and issued by the Company for the period which the convertible debenture is outstanding. The pre-emption rights will not apply to new shares issued pursuant to pro-rata public equity offerings made to all shareholders, exercise of stock options and shares issued to achieve a 25% public float.

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

20. Convertible debenture continued

- Right of first offer – While a portion of the convertible debenture is outstanding, or while CIC has a 15% direct or indirect stake in the Company, CIC has the right of first offer for any direct and indirect sale of Turquoise Hill's ownership stake in the Company. At December 31, 2014, Turquoise Hill owned directly and indirectly approximately 48% of the Company's issued and outstanding shares.

- Registration rights – CIC has registration rights under applicable Canadian provincial securities laws in connection with the common shares issuable upon conversion of the convertible debenture.

20.2 Debt host and embedded derivatives

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

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

20.3 Valuation assumptions

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

20. Convertible debenture continued

20.4 Presentation

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

For the year ended December 31, 2014, the Company recorded interest expense of $20,165 related to the convertible debenture as a finance cost (2013: $20,290). The interest expense consists of the interest at the contract rate and the accretion of the debt host component of the convertible debenture. To calculate the accretion expense, the Company uses the contract life of 30 years and an effective interest rate of 22.2%.

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

	Year ended December 31,	
	2014	2013
Balance, beginning of year	**$ 96,603**	$ 105,968
Interest expense on convertible debenture	**20,165**	20,290
Decrease in fair value of embedded derivatives	**(1,560)**	(5,481)
Interest paid	**(20,021)**	(24,174)
Balance, end of year	**$ 95,187**	$ 96,603

The convertible debenture balance consists of the following amounts:

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

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

On October 3, 2013, the Parliament of Mongolia passed the Investment Law to repeal and replace the Law on Regulation of Foreign Investment in Business Entities Operating in Sectors of Strategic Importance ("Foreign Strategic Sectors Law"). The Investment Law regulates, amongst other things, investment by Foreign State Owned Entities ("FSOEs") in sectors of strategic importance, which includes mineral resources, by requiring that FSOEs obtain a permit from Mongolia's Ministry of Economic Development if they are to acquire 33% or more of the shareholding of a Mongolian entity operating in a sector of strategic importance. The Company understands that it will not be required to obtain a permit from the Ministry of Economic Development in connection with the 1.6% share interest payment to CIC, unless such share interest payment will result in CIC acquiring 33% or more of the shareholding in the Company. The Company will fully comply with the requirements of the Investment Law in connection with share interest payments.

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

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

20. Convertible debenture continued

20.6 Interest deferral and settlement

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

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

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

21. Decommissioning liability

At December 31, 2014, the decommissioning liability primarily relates to reclamation and closure costs of the Company's Ovoot Tolgoi Mine.

The Ovoot Tolgoi Mine decommissioning liability is calculated as the net present value of the estimated future reclamation and closure costs, which at December 31, 2014 totaled $7,158 (2013: $6,286). The estimated future reclamation and closure costs are discounted at 9.9% per annum (2013: 9.6% per annum) to determine the year end decommissioning liability. The settlement of the decommissioning liability will occur through to 2031.

The movement in the decommissioning liability during the years ended December 31, 2014 and 2013 were as follows:

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

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

22. Equity

22.1 Share capital

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

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

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

22.2 Accumulated deficit and dividends

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

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

23. Share-based payments

23.1 Stock option plan

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

For the year ended December 31, 2014, the Company granted 1,924 stock options (2013: 282) to officers, employees, directors and other eligible persons at exercise prices ranging from Cdn$0.58 to Cdn$0.84 (2013: exercise prices ranging from Cdn$1.16 to Cdn$2.10) and expiry dates ranging from January 13, 2019 to August 13, 2019 (2013: expiry dates ranging from March 27, 2018 to August 14, 2018). The weighted average fair value of the options granted in the year ended December 31, 2014 was estimated at $0.22 (Cdn$0.25) (2013: $0.60, Cdn$0.62) per option at the grant date using the Black-Scholes option pricing model.

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

	Year ended December 31,	
	2014	2013
Risk free interest rate	**1.36%**	1.56%
Expected life	**3.3 years**	3.4 years
Expected volatility(i)	**56%**	56%
Expected dividend per share	**$nil**	$nil

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

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

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

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

23. Share-based payments continued

23.2 Outstanding stock options

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

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

The stock options outstanding and exercisable as at December 31, 2014 are as follows:

	Options Outstanding				Options Exercisable			
Exercise price (Cdn$)	Options outstanding		Weighted average exercise price (Cdn$)	Weighted average remaining contractual life (years)	Options outstanding and exercisable		Weighted average exercise price (Cdn$)	Weighted average remaining contractual life (years)
$0.58 – $1.92	2,151	$	0.76	4.32	207	$	1.65	3.18
$6.16 – $9.43	442		8.25	1.84	408		8.42	1.81
$12.58	460		12.58	0.62	460		12.58	0.62
	3,053	$	3.63	3.40	1,075	$	8.90	1.56

24. Reserves

24.1 Share option reserve

The Company's share option reserve relates to stock options granted by the Company to officers, employees, directors and other eligible persons under its stock option plan. Details about the Company's share-based payments are further disclosed in Note 23.

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

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

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

24. Reserves continued

24.2 Investment revaluation reserve

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

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

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

25. Capital risk management

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

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

At December 31, 2014, the Company's capital structure consists of convertible debt (Note 20), interest-bearing borrowing (Note 19) and the equity of the Company (Note 22). The Company is not subject to any externally imposed capital requirements. In order to maximize ongoing development efforts, the Company does not pay dividends.

For the year ended December 31, 2014, there were no significant changes in the processes used by the Company or in the Company's objectives and policies for managing its capital. As at December 31, 2014, the Company had limited cash of $3,789.

Based on the Company's forecasts for the year ending December 31, 2015, the Company is unlikely to have sufficient capital resources and does not expect to generate sufficient cash flows from mining operations in order to satisfy its ongoing obligations and future contractual commitments, including cash interest payments due on the CIC convertible debenture. Therefore, the Company is actively seeking additional sources of financing to continue operating and meet its objectives (Note 1).

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

26. Financial instruments and fair value measurements

26.1 Categories of financial instruments

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

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

26.2 Fair value

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

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

- The fair value of financial instruments that are traded on an active liquid market are determined with reference to the quoted market prices
- The fair value of financial instruments that are not traded in an active market are determined using generally accepted valuation models using inputs that are directly (i.e. prices) or indirectly (i.e. derived from prices) observable. The fair value of the embedded derivatives within the convertible debenture (Note 20) is determined using a Monte Carlo simulation. None of the fair value change in the embedded derivatives for the year ended December 31, 2014 is related to a change in the credit risk of the convertible debenture. All of the change in fair value is associated with changes in market conditions.

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.

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

26. Financial instruments and fair value measurements continued

26.2 Fair value continued

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

- Level 1 fair value measurements are those derived from quoted prices in active markets for identical assets or liabilities.
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1, that are observable either directly or indirectly.
- Level 3 fair value measurements are those derived from valuation techniques that include inputs that are not based on observable market data.

	As at December 31, 2014			
Recurring measurements	**Level 1**	**Level 2**	**Level 3**	**Total**
Financial iabilities at fair value				
Convertible debenture – embedded derivatives	**$ –**	**$ 1,834**	**$ –**	**$ 1,834**
Total financial liabilities at fair value	**$ –**	**$ 1,834**	**$ –**	**$ 1,834**
Non-recurring measurements				
Assets at fair value				
Inventories	**$ –**	**$ –**	**$ 1,220**	**$ 1,220**
Total assets at fair value	**$ –**	**$ –**	**$ 1,220**	**$ 1,220**

	As at December 31, 2013			
Recurring measurements	Level 1	Level 2	Level 3	Total
Financial assets at fair value				
Investment in Aspire	$ 6,175	$ –	$ –	$ 6,175
Investment in Kangaroo	222	–	–	222
Total financial assets at fair value	$ 6,397	$ –	$ –	$ 6,397
Financial liabilities at fair value				
Convertible debenture – embedded derivatives	$ –	$ 3,395	$ –	$ 3,395
Total financial liabilities at fair value	$ –	$ 3,395	$ –	$ 3,395
Non-recurring measurements				
Assets at fair value				
Inventories	$ –	$ –	$ 4,853	$ 4,853
Total assets at fair value	$ –	$ –	$ 4,853	$ 4,853

At December 31, 2014, certain coal stockpile inventories were written down to their net realizable value of $1,220 (December 31, 2013: $4,853). The net realizable value has become the carrying value and will not be revalued. Certain assumptions used in the calculation of the net realizable value are categorized as Level 3 in the fair value hierarchy. There were no transfers between Level 1, 2 and 3 for the year ended December 31, 2014.

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

26. Financial instruments and fair value measurements continued

26.3 Financial risk management objectives and policies

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

Currency risk

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

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

	As at December 31, 2014	2013
Increase/decrease in foreign exchange rate		
+5%	**$ 66**	$ 59
–5%	**$ (66)**	$ (59)

Interest rate risk

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

The Company's convertible debenture (Note 19) accrues interest at fixed rates; therefore the Company is not exposed to interest rate risk on this instrument.

Credit risk

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

The Company's credit risk on cash arises from default of the counterparty. The Company limits its exposure to counterparty credit risk on cash by only dealing with financial institutions with high credit ratings.

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

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26. Financial instruments and fair value measurements continued

26.3 Financial risk management objectives and policies continued

Liquidity risk

Liquidity risk is the risk that the Company will not be able to settle or manage its obligations associated with financial liabilities. Based on the Company's forecasts for the year ended December 31, 2015, the Company is unlikely to have sufficient capital resources and does not expect to generate sufficient cash flows from mining operations in order to satisfy its ongoing obligations and future contractual commitments, including cash interest payments due on the CIC convertible debenture. Therefore, the Company is actively seeking additional sources of financing to continue operating and meet its objectives (Note 1).

The Company's current and expected remaining contractual maturities for its financial liabilities with agreed repayment periods are as follows. The table includes the undiscounted cash flows of financial liabilities based on the earliest date on which the Company can be required to satisfy the liabilities.

	0 to 6 months	6 to 12 months	Total
As at December 31, 2014			
Trade and other payables	**$ 18,124**	**$ –**	**$ 18,124**
Interest-bearing borrowing (Note 18)	**1,972**	**1,973**	**3,945**
Convertible debenture – cash interest (Note 20) [(i)]	**8,000**	**8,000**	**16,000**
	$ 28,096	**$ 9,973**	**$ 38,069**
As at December 31, 2013			
Trade and other payables	$ 31,241	$ –	$ 31,241
Convertible debenture – cash interest (Note 20)	8,000	8,000	16,000
	$ 39,241	$ 8,000	$ 47,241

(i) The expected undiscounted cash flows of the above noted financial liabilities include the cash interest payment on the convertible debenture for the year ended December 31, 2015. Refer to Note 20 for the terms of the convertible debenture.

Commodity price risk

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

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

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

27. Related party transactions

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

Name	Country of incorporation	% equity interest As at December 31, 2014	2013
SouthGobi Resources (Hong Kong) Limited	Hong Kong	**100%**	100%
SouthGobi Sands LLC	Mongolia	**100%**	100%
SGQ Coal Investment Pte. Ltd.	Singapore	**100%**	100%

During the year ended December 31, 2014 and 2013, the Company had related party transactions with the following companies related by way of directors or shareholders in common:

- Turquoise Hill – Turquoise Hill is the Company's immediate parent company and at December 31, 2014 owned approximately 48% of the outstanding common shares of the Company. Turquoise Hill provides various administrative services to the Company on a cost-recovery basis.
- Rio Tinto – Rio Tinto is the Company's ultimate parent company and at December 31, 2014 Rio Tinto controlled Turquoise Hill. The Company recovers administration and other costs incurred on behalf of Rio Tinto on a cost-recovery basis. Rio Tinto recovers from the Company the costs of salaries and benefits of employees assigned to work for the Company and recovers legal and professional fees from the Company in respect of the internal and tripartite committees referred to in Note 24.3.
- Turquoise Hill Resources Singapore Pte. Ltd. ("Turquoise Hill Singapore") – Turquoise Hill Singapore (formerly I2MS.NET Pte. Ltd.) is a private company 100% owned by Turquoise Hill. Turquoise Hill Singapore provides information technology and other related services to the Company on a cost-recovery basis.
- Global Mining Management ("GMM") – On October 31, 2013, the Company and Turquoise Hill ceased being shareholders of GMM, a private company. GMM was owned equally by seven companies, two of which included the Company and Turquoise Hill. GMM provided administration, accounting and other office services to the Company on a cost-recovery basis. The provision of these services ceased on October 31, 2013.

27.1 Related party expenses

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

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

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

27. Related party transactions continued

27.2 Related party expense recoveries

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

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

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

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

27.3 Related party assets

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

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

27.4 Related party liabilities

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

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

27.5 Key management personnel compensation

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

	Year ended December 31, 2014	2013
Salaries, fees and other benefits	$ 2,695	$ 2,635
Share-based compensation	232	170
Total remuneration	$ 2,927	$ 2,805

28. Supplemental cash flow information

28.1 Non-cash financing and investing activities

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

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

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

28. Supplemental cash flow information continued

28.2 Net change in non-cash working capital items

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

	Year ended December, 31	
	2014	2013
Increase in inventories	$ (871)	$ (4,759)
Decrease in trade and other receivables	1,741	2,513
Decrease in prepaid expenses and deposits	863	22,552
Increase/(decrease) in trade and other payables	(13,479)	19,858
Increase/(decrease) in deferred revenue	10,900	(7,184)
Net change in non-cash working capital items	$ (846)	$ 32,980

29. Commitments for expenditure

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

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

30. Contingencies

30.1 Governmental and regulatory investigations

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

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

30. Contingencies continued

30.1 Governmental and regulatory investigations continued

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

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

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

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

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

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

30. Contingencies continued

30.2 Internal investigations

Through its Audit Committee (comprised solely of independent directors), the Company has conducted an internal investigation into possible breaches of law, internal corporate policies and codes of conduct arising from the allegations which have been raised through the investigations in Mongolia. The Chair of the Audit Committee has also participated in a tripartite committee, comprised of the Audit Committee Chairs of the Company and Turquoise Hill and a representative of Rio Tinto, which focused on the investigation of a number of those allegations, including possible violations of anti-corruption laws. The tripartite committee substantially completed the investigative phase of its activities during the third quarter of 2013. There have been no significant developments in respect of the internal investigations since the completion of the investigative phase during the third quarter of 2013.

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

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

30.3 Mongolian IAAC investigation

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

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

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

30.4 Class action lawsuit

On or about January 6, 2014, Siskinds LLP, a Canadian law firm, filed a proposed securities class action (the "Ontario Action") against the Company, certain of its former senior officers and current directors, and its former auditors, Deloitte LLP, in the Ontario Superior Court of Justice in relation to the Company's restatement of financial statements as previously disclosed in the Company's public filings.

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

30. Contingencies continued

30.4 Class action lawsuit continued

The Company disputes and will vigorously defend itself against these claims through independent Canadian litigation counsel retained by the Company and the other defendants for this purpose. Due to the inherent uncertainties of litigation, it is not possible to predict the final outcome of the Ontario Action or determine the amount of any potential losses, if any. However, the Company has judged a provision for this matter at December 31, 2014 is not required.

30.5 Toll wash plant agreement with Ejin Jinda

In 2011, the Company entered into an agreement with Ejin Jinda, a subsidiary of China Mongolia Coal Co. Ltd. to toll-wash coals from the Ovoot Tolgoi Mine. The agreement has a duration of five years from commencement of the contract and provides for an annual wet washing capacity of approximately 3.5 million tonnes of input coal. To date, commercial operations at the wet washing facility have not commenced.

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

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

The Company's objective continues to be the implementation of an effective and profitable wet washing solution, and the Company is cooperating with Ejin Jinda in reviewing the utilization of the wet washing facility.

30.6 Tax legislation

Mongolian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Company may be challenged by the relevant authorities. The Mongolian tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged by tax authorities. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for five calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

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

30. Contingencies continued

30.6 Tax legislation continued

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

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

31. Subsequent events

31.1 Private placement

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

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

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

APPENDIX TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

ADDITIONAL STOCK EXCHANGE INFORMATION

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

A1. Loss for the year

Loss for the year has been arrived at after charging the following items:

	Year ended December 31, 2014	2013
Auditor's remuneration	**$ 427**	$ 406
Loss on disposal of property, plant and equipment	**$ –**	$ 895
Depreciation and depletion		
Depreciation included in administration expenses	**$ 128**	$ 193
Depreciation included in evaluation and exploration expenses	**22**	5
Depreciation and depletion included in cost of sales	**37,540**	45,055
Total depreciation and depletion	**$ 37,690**	$ 45,253
Staff costs		
Directors' emoluments – executive directors (Note A2)	**$ 1,110**	$ 1,103
Directors' emoluments – non-executive directors (Note A2)	**538**	827
Other staff costs	**1,897**	1,985
Staff costs included in administration expenses	**3,545**	3,915
Staff costs included in evaluation and exploration expenses	**11**	46
Total staff costs	**$ 3,556**	$ 3,961

A2. Director and employee emoluments

Directors' emoluments

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

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

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

A2. Director and employee emoluments continued

Directors' emoluments continued

Year ended December 31, 2014 Name of director	Directors' fees	Salaries and other benefits	Share-based compensation	Total
Executive directors				
K. Ross Tromans (i)	$ –	$ 1,110	$ –	$ 1,110
Non-executive directors				
Kay Priestly (i)	$ 67	$ –	$ –	$ 67
Sean Hinton (i)	28	–	–	28
Kelly Sanders	41	–	–	41
Lindsay Dove (i)	22	–	–	22
Pierre Lebel	70	–	55	125
André Deepwell	62	–	55	117
W. Gordon Lancaster	58	–	55	113
Bold Baatar	23	–	–	23
Jeffery Tygesen (ii)	2	–	–	2
	$ 373	$ –	$ 165	$ 538
Directors' emoluments	$ 373	$ 1,110	$ 165	$ 1,648

(i) Resigned from the Board of Directors during the year ended December 31, 2014.

(ii) Resigned from the Board of Directors on March 18, 2015.

Year ended December 31, 2013 Name of director	Directors' fees	Salaries and other benefits	Share-based compensation	Total
Executive directors				
K. Ross Tromans	$ –	$ 1,103	$ –	$ 1,103
Non-executive directors				
Kay Priestly	$ 126	$ –	$ –	$ 126
Sean Hinton	83	59	47	189
Kelly Sanders	64	–	–	64
Brett Salt (i)	26	–	–	26
Lindsay Dove	81	–	–	81
Pierre Lebel	126	–	–	126
André Deepwell	114	–	–	114
W. Gordon Lancaster	89	–	–	89
Bold Baatar	12	–	–	12
	$ 721	$ 59	$ 47	$ 827
Directors' emoluments	$ 721	$ 1,162	$ 47	$ 1,930

(i) Resigned from the Board of Directors during the year ended December 31, 2013.

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

APPENDIX TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

A2. Director and employee emoluments continued

Five highest paid individuals

The five highest paid individuals included one director of the Company for the years ended December 31, 2014 and 2013. The emoluments of the five highest paid individuals are as follows:

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

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

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

A3. Five year summary

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

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

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

APPENDIX TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

A4. Cash

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

	As at December 31,	
	2014	2013
Denominated in U.S. Dollars	**$ 2,553**	$ 15,912
Denominated in Chinese Renminbi	**587**	4,888
Denominated in Mongolian Tugriks	**77**	632
Denominated in Canadian Dollars	**333**	200
Denominated in Hong Kong Dollars	**239**	182
Denominated in Australian Dollars	**–**	23
Cash	**$ 3,789**	$ 21,837

CORPORATE INFORMATION

Directors

Executive Director:

Mr. Ted Chan

Independent Non-Executive Directors:

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

Non-Executive Directors:

Mr. Bold Baatar
Mr. Kelly Sanders

Audit Committee

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

Nominating and Corporate Governance Committee

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

Compensation and Benefits Committee

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

Health, Environment, Safety and Social Responsibility Committee

Mr. Kelly Sanders (Chair)
Mr. Bold Baatar
Mr. Ted Chan

Company Secretary

Ms. Allison Snetsinger

Registered Office

Suite 354 – 200 Granville Street, Vancouver, British Columbia Canada V6C 1S4

Principal Place of Business in Hong Kong

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Principal Place of Business in Mongolia

8th Floor, Monnis Building, Orgil Stadium 22, Great Mongolian State Street, 15th Khoroo, Khan-Uul District, Ulaanbaatar, Mongolia 17011

Principal Bankers

Canada:

BMO Bank of Montreal

Hong Kong:

Standard Chartered Bank (Hong Kong) Limited

The Hongkong and Shanghai Banking Corporation Limited

Principal Share Registrar

CST Trust Company
Suite 1600 – 1066 West Hastings Street, Vancouver, British Columbia Canada V6E 3X1

Branch Share Registrar

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

Independent Auditor

PricewaterhouseCoopers LLP

Website address

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