SouthGobi Resources Ltd.
Management's Discussion and Analysis of Financial Condition and Results of Operations

June 30, 2016
(Expressed in U.S. Dollars)

FORWARD-LOOKING STATEMENTS

Except for statements of fact relating to the Company, certain information contained herein constitutes forward-looking statements. Forward-looking statements are frequently characterized by words such as "plan", "expect", "project", "intend", "believe", "anticipate", "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:

- the Company continuing as a going concern and its ability to realize 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 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 each of the China Investment Corporation ("CIC") convertible debenture (the "CIC Convertible Debenture"), the Turquoise Hill Resources Ltd. ("Turquoise Hill") shareholder loan (the "TRQ Loan"), the short-term bridge loan and the bank loan, as the same become due;
- the Company's anticipated financing needs, development plans and future production levels;
- the ability of the Company to satisfy the Tax Penalty (as defined under the heading "REGULATORY ISSUES AND CONTINGENCIES - Governmental and Regulatory Investigations" in this MD&A);
- the results and impact of the Ontario class action (as described under the heading "REGULATORY ISSUES AND CONTINGENCIES – Class Action Lawsuit" in this Management Discussion and Analysis of Financial Condition and Results of Operations ("MD&A"));
- 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 possible impact of changes to the inputs to the valuation model used to value the embedded derivatives in the CIC Convertible Debenture;
- the outcome of the issues described under the heading "REGULATORY ISSUES AND CONTINGENCIES" in this MD&A;
- the estimates and assumptions included in the Company's impairment analysis and the possible impact of changes thereof;
- the 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 for higher-ash product to be sold as a thermal coal product and the type of coal products being produced;
- expected impacts of the remaining administrative restrictions on certain of the Company's Mongolian assets and the anticipated impact on the Company's activities;
- the Company's anticipated business activities, planned expenditures and corporate strategies;
- the Company's intention to develop markets for its semi-soft coking coal brands and to pursue long-term supply offtake agreements with end users in the People's Republic of China ("China");
- the ability of the Company to enhance the quality of its coal products through a beneficiation process based on wet washing;
- the agreement with Ejin Jinda and payments thereunder;
- future coal market conditions in China and the related impact on the Company's margins and liquidity;
- costs relating to anticipated capital expenditures and the 2016 exploration program;

- business outlook, including the outlook for the remainder of 2016 and beyond;
- the outcome of arbitration proceedings involving the Company and First Concept Logistics Limited ("First Concept") with respect a coal supply agreement and payments thereunder;
- the outcome of legal proceedings involving the Company and its former Chief Executive Officer, Mr. Alexander Molyneux;
- the Company's objectives for the remainder of 2016 and beyond;
- the capacity and future toll rate of the paved highway;
- plans for the progress of mining license application processes;
- anticipated stock market conditions, the future prices of the Company's common shares (the "Common Shares") and ownership thereof;
- the impact of amendments to, or the application of, the laws of Mongolia and other countries in which the Company carries on business;
- the evaluation, and potential pursuit of, business opportunities other than coal mining and coal trading in Mongolia, including but not limited to power generation, contract mining and real estate;
- the impact of the Company's activities on the environment and actions taken for the purpose of mitigation of potential environmental impacts and planned focus on health, safety and environmental performance;
- 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;
- greenfield development 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.

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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 condensed consolidated interim financial statements of the Company and the notes thereto for the three and six months ended June 30, 2016. The Company’s condensed consolidated interim financial statements have been prepared in accordance with International Accounting Standard 34 “Interim Financial Reporting” using accounting policies in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”).

The condensed consolidated interim financial statements are presented in the U.S. Dollar, which is the functional currency of SouthGobi Resources Ltd. and its controlled subsidiaries. The functional currency of RDCC LLC, the joint venture in respect of the paved highway and in which the Company has an indirect 40% interest, is the Mongolian Tugrik (“MNT”). The functional currency of two 100% owned Chinese subsidiaries, Inner Mongolia Southgobi Energy Limited, which was incorporated in June 2016, and SouthGobi Trading (Beijing) Co., Ltd. is Renminbi. 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 in respect of the Company’s material mineral projects was prepared by or under the supervision of the Qualified Persons (as that term is defined in NI 43 – 101) (“QPs”) listed below and is derived from the technical report prepared for the Ovoot Tolgoi Deposit dated May 6, 2016 (the "Ovoot Tolgoi Technical Report 2016") prepared by RungePincockMinarco ("RPM"), the technical report on the Soumber Deposit dated March 25, 2013 (the "Soumber Technical Report") prepared by RPM (known then as Minarco-MineConsult), the technical report on the Zag Suuj Deposit dated March 25, 2013 (the "Zag Suuj Technical Report") prepared by RPM (known then as Minarco-MineConsult). Copies of the Ovoot Tolgoi Technical Report 2016, 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	Brendan Stats	Resources	Independent Consultant
Soumber	Merryl Peterson	Resources	Independent Consultant
Zag Suuj	Merryl Peterson	Resources	Independent Consultant

1. OVERVIEW

The Company is an integrated coal mining, development and exploration company with 356 employees as at June 30, 2016. 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.

The Company owns the Ovoot Tolgoi open pit coal mine (the "Ovoot Tolgoi Mine") and the following significant development projects, 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 Company owns a 100% interest in the Ovoot Tolgoi Mine.

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, on the Chinese side of the Shivee Khuren Border Crossing, is a major Chinese coal distribution terminal with rail connections to key coal markets in the People's Republic of China ("China").

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.

Significant Events and Highlights

The Company's significant events and highlights for the three months ended June 30, 2016 and subsequent period up to August 15, 2016 are as follows:

- ***Operating results*** – The Company continues to operate under difficult market conditions as prices for coal remained weak in China through the second quarter of 2016. The impact of these conditions on the Company's operations continues to be exacerbated given the Company's liquidity constraints. The Company sold 0.82 million tonnes of its coal products during the quarter compared to 0.19 million tonnes in the second quarter of 2015. The production for the second quarter of 2016 was 0.67 million tonnes compared to 0.62 million tonnes for the second quarter of 2015.

- ***Shareholder loan*** - On May 16, 2016, Turquoise Hill signed a deferral letter agreement with the Company ("May 2016 Deferral Letter Agreement"), in which Turquoise Hill agreed to a limited and circumscribed deferral of repayment of all remaining amounts and obligations now and hereafter owing under the TRQ Loan to December 29, 2017. The Company has agreed to repay $0.15 million per month starting on May 31, 2016 and ending on April 28, 2017; $0.2 million per month starting on May 31, 2017 and ending on December 29, 2017, at which time all remaining obligations will become due. Interest shall continue to accrue on all outstanding obligations at 12-month US dollar LIBOR rate. The amount due in May to July 2016 has been paid as at August 15, 2016.

- ***Class Action Lawsuit*** - On May 24, 2016, the Ontario Superior Court of Justice granted the Company leave to appeal the decision made on November 5, 2015, which granted the plaintiff permission to commence an action claiming damages under the Ontario Securities Act with respect to the Company's restatement of financial statements as previously disclosed in the Company's public filings.

  The plaintiff has also appealed. The Ontario Court of Appeal granted an adjournment of the plaintiff's original hearing date of June 27, 2016, pending the expected consolidation of the Divisional Court appeal brought on behalf of the Company. The parties have consented to a consolidation of the appeals in principle and are negotiating the terms of the Consent Order. It is expected that the Motion seeking consolidation on consent will be filed with the Court in August and the Court of Appeal will deal with the consolidation quickly. Assuming that the Court of Appeal will grant the consent order, the appeals will be perfected in September and heard together in the spring of 2017.

- ***CIC Convertible Debenture*** – On July 13, 2016, the Company executed a deferral agreement with CIC which covers outstanding deferred cash interest obligations and associated costs of $18.8 million as of July 13, 2016 and the next Issue Date Anniversary Cash Interest payment of $8.1 million due on November 19, 2016. Pursuant to the deferral agreement, the Company has agreed to repay $1.3 to $1.4 million monthly from July to November 2016 and repay $20.7 million on December 19, 2016. In consideration for the deferred payments of $18.8 million, the Company will pay a deferral fee at a rate of 6.4% per annum to CIC. The interest due in July 2016 has been paid as at August 15, 2016.

  Although CIC and the Company had finalized the terms of a deferral of CIC interest payments at the end of the second quarter, a formal written agreement had not been executed as at June 30, 2016. As a consequence, International Accounting Standard 1 ("IAS 1") required the Company to classify the entire balance of the CIC Convertible Debenture as a current liability as at June 30, 2016, notwithstanding the fact that CIC had agreed to the terms of the deferral and had not indicated any intention to deliver notice of default or accelerate the maturity of the debenture. Following the execution of the deferral agreement on July 13, 2016, the CIC Convertible Debenture met the requirements of IAS 1. The Company anticipates that both the debt host and the fair value of the embedded derivative will be classified as a non-current liability going forward, unless a future event of default occurs under the terms of the CIC Convertible Debenture.

- ***Short-term bridge loan*** – The Company repaid the first tranche of the short-term bridge loan of $4.9 million on July 26, 2016. During June and July 2016, the Company drew the second tranche of $5.0 million. $1.5 million and $3.5 million will mature in March and April 2017, respectively.

- ***Retirement of a Director*** – Mr. Pierre Lebel retired as Lead director and Independent Non-Executive Director on June 30, 2016.

- ***Going Concern*** - As at the date hereof, the Company is focused on securing additional sources of financing and continues to minimize uncommitted capital expenditures in order to pay the interest due under the CIC Convertible Debenture, the short-term bridge loan, the TRQ Loan and the bank loan, meet the Company's obligations as they fall due and achieve its business objectives in 2016. However, there is no guarantee that the Company will be able to successfully secure additional sources of financing. 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. If the Company is unable to continue as a going concern it may be forced to seek relief under applicable bankruptcy and insolvency legislation. See section 5 “Liquidity and Capital Resources” and section 11 “Risk Factors” for details. As at August 15, 2016, the Company had cash of $ 0.8 million.

2. OVERVIEW OF OPERATIONAL DATA AND FINANCIAL RESULTS

Summary of Operational Data

	Three months ended June 30,		Six months ended June 30,	
	2016	**2015**	**2016**	**2015**
Sales Volumes, Prices and Costs				
Premium semi-soft coking coal				
Coal sales *(millions of tonnes)*	**-**	0.02	**0.06**	0.02
Average realized selling price *(per tonne)* (i)	**$ -**	$ 23.37	**$ 21.38**	$ 23.37
Standard semi-soft coking coal				
Coal sales *(millions of tonnes)*	**0.52**	0.11	**1.10**	0.16
Average realized selling price *(per tonne)* (i)	**$ 16.27**	$ 19.97	**$ 17.40**	$ 19.31
Thermal coal				
Coal sales *(millions of tonnes)*	**0.30**	0.06	**0.54**	0.19
Average realized selling price *(per tonne)* (i)	**$ 9.17**	$ 10.47	**$ 9.18**	$ 10.46
Total				
Coal sales *(millions of tonnes)*	**0.82**	0.19	**1.70**	0.37
Average realized selling price *(per tonne)* (i)	**$ 13.65**	$ 17.42	**$ 14.92**	$ 15.15
Raw coal production *(millions of tonnes)*	**0.67**	0.62	**1.04**	0.62
Direct cash costs of product sold *(per tonne)* (ii)	**$ 12.47**	$ 15.57	**$ 10.17**	$ 12.27
Mine administration cash costs of product sold *(per tonne)* (ii)	**$ 2.32**	$ 7.90	**$ 1.76**	$ 5.13
Total cash costs of product sold *(per tonne)* (ii)	**$ 14.79**	$ 23.47	**$ 11.93**	$ 17.40
Other Operational Data				
Production waste material moved *(millions of bank cubic meters)*	**1.82**	3.62	**2.54**	3.62
Strip ratio *(bank cubic meters of waste material per tonne of coal produced)*	**2.71**	5.87	**2.43**	5.87
Lost time injury frequency rate (iii)	**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 3. 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.

Overview of Operational Data

The Company ended the second quarter of 2016 without a lost time injury. As at June 30, 2016, the Company has a lost time injury frequency rate of nil per 200,000 man hours based on a rolling 12 month average.

For the three months ended June 30, 2016

Market conditions and prices for coal remained weak in China through the second quarter of 2016. The impact of these conditions was exacerbated given the depreciation of Renminbi against USD. The Company sold 0.82 million tonnes of its coal products during the second quarter of 2016 compared to 0.19 million tonnes for the second quarter of 2015. The Company is pacing production with current and expected demand, production was 0.67 million tonnes for the quarter as compared to 0.62 million tonnes for the second quarter of 2015.

For the six months ended June 30, 2016

During the first six months of 2016 market conditions and prices for coal remained weak in China. The Company sold 1.70 million tonnes of its coal products during the first six months of 2016 compared to 0.37 million tonnes for the first six months of 2015.

The production in the first six months of 2016 was higher than the first six months of 2015 as a result of pacing production with the current and expected demand.

Summary of Financial Results

	Three months ended June 30,		Six months ended June 30,	
$ in thousands, except per share information	**2016**	**2015**	**2016**	**2015**
Revenue [(i),(ii)]	**$ 10,361**	$ 2,951	**$ 23,088**	$ 4,536
Cost of sales [(ii)]	**(23,105)**	(11,835)	**(42,185)**	(29,511)
Gross loss excluding idled mine asset costs	**(9,926)**	(5,017)	**(10,975)**	(6,246)
Gross loss including idled mine asset costs	**(12,744)**	(8,884)	**(19,097)**	(24,975)
Other operating income/(expenses)	**812**	(19,450)	**(899)**	(18,479)
Administration expenses	**(1,826)**	(1,961)	**(3,468)**	(3,388)
Evaluation and exploration expenses	**(52)**	22	**(99)**	(56)
Loss from operations	**(13,810)**	(30,273)	**(23,563)**	(46,898)
Finance costs	**(5,377)**	(5,222)	**(10,845)**	(11,605)
Finance income	**324**	273	**296**	16
Share of earnings of a joint venture	**256**	151	**339**	133
Income tax expense	**(23)**	(1)	**(258)**	(1)
Net loss	**(18,630)**	(35,072)	**(34,031)**	(58,355)
Basic and diluted loss per share	**$ (0.07)**	$ (0.15)	**$ (0.13)**	$ (0.25)

(i) Revenue is presented after the deduction of royalties and selling fees.
(ii) Revenue and cost of sales relate to the Company's Ovoot Tolgoi Mine within the Coal Division operating segment. Refer to note 3 of the condensed consolidated interim financial statements for further analysis regarding the Company's reportable operating segments.

Overview of Financial Results

For the three months ended June 30, 2016

The Company recorded a $13.8 million loss from operations in the second quarter of 2016 compared to a $30.3 million loss from operations in the second quarter of 2015. The operations for the three months ended June 30, 2016 were impacted by continuing difficult market conditions and weaker coal prices experienced by the Company.

Revenue was $10.4 million in the second quarter of 2016 compared to $3.0 million in the second quarter of 2015. The Company sold 0.82 million tonnes of coal at an average realized selling price of $13.65 per tonne in the second quarter of 2016 compared to sales of 0.19 million tonnes at an average realized selling price of $17.42 per tonne in the second quarter of 2015. The decrease in the average realized selling price mainly resulted from continued difficult market conditions as well as the depreciation of Renminbi against USD. The product mix for the second quarter of 2016 consisted of approximately 63% of Standard semi-soft coking coal and 37% of thermal coal compared to approximately 69% of Premium and Standard semi-soft coking coal and 31% of thermal coal in the second quarter of 2015.

The Company's revenue is presented after the deduction of royalties and selling fees. The Company's effective royalty rate for the second quarter of 2016, based on the Company's average realized selling price of $13.65 per tonne, was 6.9% or $0.95 per tonne compared to 10.7% or $1.86 per tonne based on the average realized selling price of $17.42 per tonne in the second quarter of 2015.

Royalty regime in Mongolia

The royalty regime in Mongolia is evolving and has been subject to change since 2012.

On February 1, 2016, the Government of Mongolia issued a resolution in connection to the royalty regime. From February 1, 2016 onwards, royalties are calculated based on the actual contract price in which transportation cost to the Mongolia border should have been included. If such transportation cost was not included in the contract, the relevant transportation costs, custom documentation fees, insurance and loading cost should be estimated for the calculation of royalties. In the event that the calculated sales price as described above differs from the contract sales price of other entities in Mongolia (same quality of coal and same border crossing) by more than 10%, the calculated sales price will be deemed to be "non-market" under Mongolian tax law and the royalty will then be calculated based on a reference price as determined by the Government of Mongolia.

Cost of sales was $23.1 million in the second quarter of 2016 compared to $11.8 million in the second quarter of 2015. 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 3 for further analysis) during the period.

	Three months ended June 30,	
$ in thousands	**2016**	**2015**
Operating expenses	**$ 10,488**	$ 4,571
Share-based compensation expense/(recovery)	**(3)**	4
Depreciation and depletion	**6,253**	832
Impairment of coal stockpile inventories	**3,549**	2,561
Cost of sales from mine operations	**20,287**	7,968
Cost of sales related to idled mine assets	**2,818**	3,867
Cost of sales	**$ 23,105**	$ 11,835

Operating expenses in cost of sales were $10.5 million in the second quarter of 2016 compared to $4.6 million in the second quarter of 2015. The increase in operating expenses is primarily related to the increase in sales volume from 0.19 million tonnes in the second quarter of 2015 to 0.82 million tonnes in the second quarter of 2016.

Cost of sales in the second quarter of 2016 and 2015 included coal stockpile impairments of $3.5 million and $2.6 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 the second quarter of 2016 and 2015 reflected 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 the second quarter of 2016 included $2.8 million of depreciation expenses for idled equipment compared to $3.9 million in the second quarter of 2015.

Other operating income was $0.8 million in the second quarter of 2016 compared to other operating expenses of $19.5 million in the second quarter of 2015 as follows:

	Three months ended June 30,	
$ in thousands	**2016**	**2015**
Foreign exchange loss	**$ 1,786**	$ 1,196
Provision/(reverse of provision) for doubtful trade and other receivables	**(1,909)**	157
Provision for court case penalty	**-**	18,049
Discount on settlement of trade payables	**(1,009)**	-
Others	**320**	48
Other operating expenses/(income)	**$ (812)**	$ 19,450

For the three months ended June 30, 2016, the Company reversed a provision for doubtful trade and other receivables of $1.9 million (2015: provision of $0.2 million was made) as a result of collecting long aged receivables in the second quarter of 2016. In addition, a settlement plan with a supplier of machinery was reached in the second quarter of 2016 and a discount on settlement of $1.0 million was recorded accordingly.

Administration expenses were $1.8 million in the second quarter of 2016 compared to $2.0 million in the second quarter of 2015 as follows:

	Three months ended June 30,	
$ in thousands	**2016**	**2015**
Corporate administration	**$ 693**	$ 512
Legal and professional fees	**391**	890
Salaries and benefits	**677**	472
Share-based compensation expense	**12**	47
Depreciation	**53**	40
Administration expenses	**$ 1,826**	$ 1,961

Administration expenses were lower for the second quarter of 2016 compared to the second quarter of 2015 primarily due to lower legal and professional fees incurred in the second quarter of 2016.

Evaluation and exploration expenses were $0.1 million in the second quarter of 2016. The Company continued to minimize evaluation and exploration expenditures in the second quarter of 2016 in order to preserve the Company's financial resources.

Finance costs were $5.4 million and $5.2 million respectively in the second quarter of 2016 and the second quarter of 2015. Finance costs primarily consisted of interest expense in respect of the $250.0 million CIC Convertible Debenture ($5.3 million for the second quarter of 2016 and $5.1 million for the second quarter of 2015).

For the six months ended June 30, 2016

The Company recorded a $23.6 million loss from operations in the first six months of 2016 compared to a $46.9 million loss from operations in the first six months of 2015. The operations for the six months ended June 30, 2016 were impacted by continuing difficult market conditions and weak coal prices in China. Whilst the Company resumed production on March 30, 2015, the results for the first six months of 2015 were primarily impacted as a consequence of the tax investigation case in Mongolia as a provision of $18.0 million was recorded in respect of the Tax Penalty during the six months ended June 30, 2015.

Revenue was $23.1 million in the first six months of 2016 compared to $4.5 million in the first six months of 2015. The Company sold 1.70 million tonnes of coal at an average realized selling price of $14.92 per tonne in the first six months of 2016 compared to sales of 0.37 million tonnes at an average realized selling price of $15.15 per tonne in the first six months of 2015. The benefit of the improved product mix has been more than offset by continued declining prices for the first six months of 2016 when compared to the first six months of 2015.

The Company's revenue is presented net of royalties and selling fees. With the changes affecting the royalty regime in Mongolia, the Company's effective royalty rate for the first six months of 2016, based on the Company's average realized selling price of $14.92 per tonne, was 7.0% or $1.05 per tonne compared to 18.0% or $2.73 per tonne based on the average realized selling price of $15.15 per tonne in the first six months of 2015.

Cost of sales was $42.2 million in the first six months of 2016 compared to $29.5 million in the first six months of 2015.

	Six months ended June 30,	
$ in thousands	**2016**	**2015**
Operating expenses	**$ 18,533**	$ 6,498
Share-based compensation expense/(recovery)	**(8)**	32
Depreciation and depletion	**9,832**	1,141
Impairment of coal stockpile inventories	**5,706**	3,111
Cost of sales from mine operations	**34,063**	10,782
Cost of sales related to idled mine assets	**8,122**	18,729
Cost of sales	**$ 42,185**	$ 29,511

Operating expenses in cost of sales were $18.5 million in the first six months of 2016 compared to $6.5 million in the first six months of 2015. The increase in operating expenses is primarily related to the increase in sales volume from 0.37 million tonnes in the first six months of 2015 to 1.70 million tonnes in the first six months of 2016.

Cost of sales in the first six months of 2016 and the first six months of 2015 included coal stockpile impairments of $5.7 million and $3.1 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 2016 and 2015 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 primarily included depreciation expense. Cost of sales related to idled mine assets in the first six months of 2016 included $8.1 million related to depreciation expenses for idled equipment (2015: $15.8 million). Idled mine asset costs decreased in the first six months of 2016 compared to the first six months of 2015 as a result of the period of curtailment until March 30, 2015 when mining operations recommenced.

However, neither the production plan for the first six months of 2016 nor for the period from March 30, 2015 until June 30, 2015 fully utilized the Company's existing mining fleet, therefore, idled mine asset costs continued to be incurred.

Other operating expenses were $0.9 million in the first six months of 2016 compared to $18.5 million in the first six months of 2015.

	Six months ended June 30,	
$ in thousands	**2016**	**2015**
Foreign exchange loss	**$ 1,514**	$ 138
Provision for doubtful trade and other receivable	**2**	157
Provision for court case penalty	**-**	18,049
Discount on settlement of trade payables	**(1,009)**	-
Others	**392**	135
Other operating expenses	**$ 899**	$ 18,479

The Company recognized an expense for the provision of the Tax Penalty in respect of the tax investigation case in Mongolia. The Tax Penalty amounts to MNT35.3 billion (approximately $18.0 million at June 30, 2015).

Administration expenses were $3.5 million in the first six months of 2016 compared to $3.4 million in the first six months of 2015.

	Six months ended June 30,	
$ in thousands	**2016**	**2015**
Corporate administration	**$ 1,158**	$ 958
Legal and professional fees	**895**	1,365
Salaries and benefits	**1,320**	852
Share-based compensation expense	**5**	147
Depreciation	**90**	66
Administration expenses	**$ 3,468**	$ 3,388

Evaluation and exploration expenses were $0.1 million in both the first six months of 2016 and the first six months of 2015. The Company continued to minimize evaluation and exploration expenditures in the first six months of 2016 in order to preserve the Company's financial resources. Evaluation and exploration activities and expenditures in the first six months of 2016 were limited to ensuring that the Company met the Mongolian Minerals Law requirements in respect of its mining and exploration licenses.

Finance costs were $10.8 million and $11.6 million in the first six months of 2016 and 2015 respectively. This primarily consisted of interest expense on the CIC Convertible Debenture ($10.5 million for the first six months of 2016 and $10.1 million for the first six months of 2015).

Finance costs for the first six months of 2015 also included $1.3 million in respect of the unrealized fair value loss of the embedded derivative in the CIC Convertible Debenture. In comparison, in the first six months of 2016, the Company recorded within finance income an unrealized fair value gain of the embedded derivative in the CIC Convertible Debenture ($0.3 million). The fair value of the embedded derivatives in the CIC Convertible Debenture is driven by many factors including: the Common Share price, U.S. Dollar and Canadian Dollar exchange rates and share price volatility.

Summary of Quarterly Operational Data

	2016		2015				2014	
Quarter Ended	**30-Jun**	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec	30-Sep
Sales Volumes, Prices and Costs								
Premium semi-soft coking coal								
Coal sales *(millions of tonnes)*	**-**	0.06	0.04	0.16	0.02	-	0.02	-
Average realized selling price *(per tonne)* (i)	**$ -**	$ 21.38	$ 21.72	$ 22.32	$ 23.37	$ -	$ 26.77	$ -
Standard semi-soft coking coal								
Coal sales *(millions of tonnes)*	**0.52**	0.58	0.12	0.31	0.11	0.05	0.14	0.31
Average realized selling price *(per tonne)* (i)	**$ 16.27**	$ 18.42	$ 18.91	$ 19.10	$ 19.97	$ 17.95	$ 18.32	$ 17.41
Thermal coal								
Coal sales *(millions of tonnes)*	**0.30**	0.24	0.05	0.02	0.06	0.13	0.21	0.34
Average realized selling price *(per tonne)* (i)	**$ 9.17**	$ 9.19	$ 9.26	$ 10.48	$ 10.47	$ 10.46	$ 11.69	$ 10.66
Total								
Coal sales *(millions of tonnes)*	**0.82**	0.88	0.21	0.49	0.19	0.18	0.37	0.65
Average realized selling price *(per tonne)* (i)	**$ 13.65**	$ 16.11	$ 17.19	$ 19.76	$ 17.42	$ 12.66	$ 15.04	$ 13.87
Raw coal production *(millions of tonnes)*	**0.67**	0.37	0.62	0.71	0.62	-	0.21	0.17
Direct cash costs of product sold *(per tonne)* (ii)	**$ 12.47**	$ 7.88	$ 6.55	$ 17.46	$ 15.57	$ 8.68	$ 8.09	$ 7.38
Mine administration cash costs of product sold *(per tonne)* (ii)	**$ 2.32**	$ 1.24	$ 1.78	$ 2.81	$ 7.90	$ 2.11	$ 2.44	$ 2.30
Total cash costs of product sold *(per tonne)* (ii)	**$ 14.79**	$ 9.12	$ 8.33	$ 20.27	$ 23.47	$ 10.79	$ 10.53	$ 9.68
Other Operational Data								
Production waste material moved *(millions of bank cubic meters)*	**1.82**	0.72	1.08	2.33	3.62	-	0.55	0.20
Strip ratio *(bank cubic meters of waste material per tonne of coal produced)*	**2.71**	1.94	1.75	3.25	5.87	-	2.61	1.20
Lost time injury frequency rate (iii)	**0.00**	0.00	0.00	0.00	0.00	0.25	0.21	0.17

(i) *Average realized selling price is presented before deduction of royalties and selling fees.*
(ii) *A non-IFRS financial measure, see section 3. 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.*

Summary of Quarterly Financial Results

The Company's financial statements are reported under IFRS issued by the IASB. The following tables provide highlights, extracted from the Company's annual and interim financial statements, of quarterly results for the past eight quarters:

$ in thousands, except per share information	2016		2015				2014	
Quarter Ended	**30-Jun**	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec	30-Sep
Financial Results								
Revenue (i), (ii)	**$ 10,361**	$ 12,727	$ 2,873	$ 8,621	$ 2,949	$ 1,587	$ 5,054	$ 7,611
Cost of sales (ii)	**(23,105)**	(19,080)	(12,072)	(22,108)	(11,833)	(17,678)	(19,757)	(23,922)
Gross loss excluding idled mine asset costs	**(9,926)**	(1,049)	(5,338)	(10,641)	(5,017)	(1,230)	(821)	(2,178)
Gross loss including idled mine asset costs	**(12,744)**	(6,353)	(9,199)	(13,487)	(8,884)	(16,091)	(14,703)	(16,311)
Other operating income/(expenses)	**812**	(1,711)	(1,093)	621	(19,450)	971	(3,386)	(2)
Administration expenses	**(1,826)**	(1,642)	(2,154)	(1,967)	(1,963)	(1,425)	(1,924)	(2,530)
Evaluation and exploration expenses	**(52)**	(47)	(46)	(40)	22	(81)	(911)	(122)
Impairment of property, plant and equipment	**-**	-	(92,651)	-	-	-	(8,603)	-
Loss from operations	**(13,810)**	(9,753)	(105,143)	(14,873)	(30,275)	(16,626)	(29,527)	(18,965)
Finance costs	**(5,377)**	(5,497)	(5,694)	(5,351)	(5,222)	(6,648)	(6,351)	(5,257)
Finance income	**324**	1	580	1,984	274	8	317	135
Share of earnings/(losses) of a joint venture	**256**	83	(7)	99	151	(18)	(40)	(32)
Income tax expense	**(23)**	(235)	(2)	(1)	(1)	-	(40)	-
Net loss	**(18,630)**	(15,401)	(110,266)	(18,142)	(35,073)	(23,284)	(35,641)	(24,119)
Basic and dilute loss per share	**$ (0.07)**	$ (0.06)	$ (0.44)	$ (0.07)	$ (0.15)	$ (0.11)	$ (0.19)	$ (0.13)

(i) *Revenue is presented after the deduction of royalties and selling fees.*
(ii) *Revenue and cost of sales relate to the Company's Ovoot Tolgoi Mine within the Coal Division operating segment. Refer to note 3 of the condensed consolidated interim financial statements for further analysis regarding the Company's reportable operating segments.*

3. 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 cash 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.

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 per tonne of product sold presented below may differ from cash costs per tonne of product produced depending on the timing of coal stockpile inventory turnover and impairments of coal stockpile inventories from prior periods.

	Three months ended June 30,		Six months ended June 30,	
$ in thousands, except per tonne information	**2016**	**2015**	**2016**	**2015**
Cash costs				
Cost of sales determined in accordance with IFRS	**$ 23,105**	$ 11,835	**$ 42,185**	$ 29,511
Less non-cash expenses	**(8,088)**	(3,397)	**(13,819)**	(4,284)
Less non-cash idled mine asset costs	**(2,818)**	(3,867)	**(8,122)**	(15,755)
Total cash costs	**12,199**	4,571	**20,244**	9,472
Less idled mine asset cash costs	**-**	-	**-**	(2,972)
Total cash costs excluding idled mine asset cash costs	**12,199**	4,571	**20,244**	6,500
Coal sales *(millions of tonnes)*	**0.82**	0.19	**1.70**	0.37
Total cash costs of product sold *(per tonne)*	**$ 14.79**	$ 23.47	**$ 11.93**	$ 17.40

	Three months ended June 30,		Six months ended June 30,	
$ in thousands, except per tonne information	**2016**	**2015**	**2016**	**2015**
Cash costs				
Direct cash costs of product sold *(per tonne)*	**$ 12.47**	$ 15.57	**$ 10.17**	$ 12.27
Mine administration cash costs of product sold *(per tonne)*	**2.32**	7.90	**1.76**	5.13
Total cash costs of product sold *(per tonne)*	**$ 14.79**	$ 23.47	**$ 11.93**	$ 17.40

4. PROPERTIES

The Company currently holds four mining licenses and two exploration licenses in Mongolia, which in total cover an area of approximately 98,000 hectares ("ha").

The mining licenses pertain to the Ovoot Tolgoi Mine (12726A) and the Soumber Deposit (MV-016869, MV-025436 and MV-020451).

The two exploration licenses held by the Company are 13779X and 5267X, which are pertaining to the Zag Suuj Deposit for which pre-mining agreements ("PMAs") have been issued.

Two exploration licenses (9443X and 9449X) were converted to mining licenses (MV-025436 and MV-020451) by the Mineral Resources Authority of Mongolia ("MRAM") in January 2016.

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.

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.

Resources

As a consequence of material changes in some key assumptions underlying the analysis of its resources subsequent to the last detailed review of the project in 2012, particularly those relating to ongoing changes in coal market conditions and geologic analysis, the Company has updated its mineral resource estimate for the Ovoot Tolgoi Project, resulting in a decrease in estimated mineral resources from the previous estimate completed in 2012. The decrease is principally based on the exclusion of underground mineralization from the resources estimate and a reclassification of the geology type of certain zones in the mine based on detailed analysis of the results of additional drilling and mining activities since 2012.

In the context of current coal market conditions, and in particular, a significant decline in coal prices in China, the Company's principal market, mineralization in the 350m to 600m underground portion of the Ovoot Tolgoi Mine is now assessed by the Company as not having reasonable prospects for eventual economic extraction.

A reclassification of certain zones in the Ovoot Tolgoi deposit by the Company's independent mining consultants, RPM (known then as Minarco-MineConsult), from a degree of geological complexity that was previously characterized as "Complex" to "Severe" (as defined in Geological Survey of Canada Paper 88-21) has necessitated downgrading quantities of the previously estimated resources from the measured category to the indicated and inferred categories. The "Severe" classification requires much tighter data point spacing of drilling results to support the degree of confidence necessary for a categorization of resources as measured.

Updated resources have been estimated as of January 1, 2015 and the revised technical report prepared by RPM (known then as Minarco-MineConsult) for the Ovoot Tolgoi Deposit was filed on May 13, 2016.

The updated estimate of resources at the Ovoot Tolgoi deposit is summarized in the table below.

Field	**Seam Group**	**Resources Mt**		
		Measured	**Indicated**	**Inferred**
Sunrise (depth <350m)	7	-	-	3
	6U	-	-	10
	6L	-	-	4
	5U	-	21.0	20
	5L	-	50.9	15
	Subtotal	**-**	**72**	**53**
Sunset (depth <350m)	10	-	10.8	2
	09	-	29.7	3
	08	-	7.7	1
	5U	-	33.3	7
	5L	-	16.4	13
	Subtotal	**-**	98	**26**
Ovoot Tolgoi (depth <350m)	**Grand Total**	**-**	**170**	**78**

The criteria used to limit the resources are:

- Minimum coal thickness = 0.3metres (m) (previous estimates used 0.3m);
- Minimum coal parting = 0.2m (previous estimates used 0.3m);
- Base of weathering = 4m (same as previous estimate);
- Resources are limited to a depth of 350m;
- Volumes are converted to tonnages using laboratory relative density analytical results converted to an estimated in-situ basis;
- Resources are limited to the mining license boundary;
- The Resource estimations contained within are on an in-situ basis (i.e. as an in-situ tonnage and not adjusted for mining losses or recovery);
- Resources depleted by mined out tonnage (as of January 1, 2015). Mined out surfaces are based on survey data from January 27, 2015 for the Sunrise Field and November 19, 2014 for the Sunset Field. No mining activity has taken place since the survey information was collected that would materially affect the resources estimate; and

- Totals may not add up due to rounding.

The Company previously reported 175.7 million tonnes of proven and probable reserves in respect of the Ovoot Tolgoi deposit based on a preliminary feasibility study completed in 2012. Since the previously reported estimate of reserves was derived from the 2012 resource estimate that has now been updated and revised as noted above, and a number of key assumptions upon which the 2012 reserve estimate was based have now materially changed, it is expected that, once all relevant factors have been fully analyzed such that an updated reserve estimate can be prepared, the reserves previously reported in respect of the Ovoot Tolgoi deposit will also be quantitatively reduced and qualitatively downgraded. Additional drilling will likely be required to establish the degree of confidence required to produce an updated estimate of reserves.

The Company is engaged in a comprehensive review of the mine plan's design parameters, mine design and project development schedule in order to reflect an updated production plan and current market conditions. The objective of this exercise is to optimize the Company's mine plan having regard to the change in circumstances since the 2012 preliminary feasibility study was prepared. Factors 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 can be expected to exert downward pressure on reserve quantities. These may be offset to some degree by an upgrading of some resources from the inferred category to the 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. However, there can be no assurance that the continuing optimization of the mine plan at the Ovoot Tolgoi Mine will ultimately provide the basis for an updated preliminary feasibility study that will support a new estimate of mineral reserves.

Any downward adjustments to the Company's mineral reserve estimates could materially affect the Company's development and mining plans, which could materially and adversely affect its business and results of operations.

See Risk Factor entitled "There can be no assurance that the continuing optimization of the mine plan at the Ovoot Tolgoi Mine will ultimately provide the basis for an updated preliminary feasibility study that will support a new estimate of mineral reserves" in the Company's MD&A for the year ended December 31, 2015 available on SEDAR at www.sedar.com.

Operational Data and Financial Results

Refer to section 2 for an overview of the operational data and financial results of the Ovoot Tolgoi Mine.

Transportation Infrastructure

On August 2, 2011, the State Property Committee of Mongolia awarded the tender to construct a paved highway from the Ovoot Tolgoi Mine to the Shivee Khuren Border Crossing (the "Paved Highway") to consortium partners NTB LLC and SouthGobi Sands LLC ("SGS"), the Company's wholly-owned subsidiary, (together referred to as "RDCC LLC"). The Company has an indirect 40% shareholding in RDCC LLC through its Mongolian subsidiary SGS.

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.

On May 8, 2015, the commercial operation of the Paved Highway commenced and subsequently the unpaved highway which was previously used to transport coal through the Shivee Khuren Border Crossing was closed. The Paved Highway has significantly increased the safety of coal transportation, reduced environmental impacts and improved efficiency and capacity of coal transportation. The current toll rate is set at nine hundred (900) MNT per tonne of coal as compared to fifteen hundred (1,500) MNT as stated in the signed concession agreement between RDCC LLC and the State Property Committee of Mongolia.

On September 17, 2015, the Invest Mongolia Agency signed an amendment to the concession agreement with RDCC LLC to extend the exclusive right of ownership to 30 years.

The Paved Highway has a carrying capacity in excess of 20 million tonnes of coal per year.

For the three and six months ended June 30, 2016, RDCC LLC recognized toll fee revenue of $1.4 million (2015: $0.5 million) and $2.2 million (2015: $0.5 million), respectively.

Mining Equipment

The key elements of the currently commissioned mining fleet includes: two Liebherr 996 (33m3 & 36m3) hydraulic excavators, three Liebherr R9250 (15m3) hydraulic excavators, 23 MT4400AC (218 tonne capacity) haul trucks and three Terex TR100 (91 tonne capacity) haul trucks, together with various pieces of ancillary equipment.

Workforce

As at June 30, 2016, SGS employed 336 employees in Mongolia. Of the 336 employees, 41 are employed in the Ulaanbaatar office, 3 in outlying offices and 292 at the Ovoot Tolgoi Mine site. Of the 336 employees based in Mongolia, 335 (99%) are Mongolian nationals and of those, 164 (49%) 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 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 (9443X and 9449X) pertaining to certain areas associated with the Soumber Deposit for which PMAs have been issued. In January 2016, these two exploration licenses were being converted to mining licenses (MV-025436 and MV-020451) by MRAM.

A territory (Central, East Soumber and Biluut) covering the Soumber Deposit mining license area was designated by the provincial authorities as a special protected area (refer to section 6 "Regulatory Issues and Contingencies" for details of the status of the Soumber Deposit in respect of the latest decision by the provincial authorities).

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.

Mining activities at the Soumber property cannot proceed until the License Areas are removed from the Special Needs Territory. Refer to section 6 "Special Needs Territory in Umnugobi" for the mining restriction that has been in place for the Soumber Deposit.

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 Mine 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 coal 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 2016 will 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. In the context of current coal market conditions, and in particular, a significant decline in coal prices in China, the Company's principal market, underground mineralization is now assessed by the Company as not having reasonable prospects for eventual economic extraction.

Exploration Program

The Company continued to minimize evaluation and exploration expenditures during 2016 in order to preserve the Company's financial resources. The 2016 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.

5. 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 the TRQ Loan in the form of a $10 million revolving credit facility to meet its short term working capital requirements. The terms and conditions of this facility were filed on SEDAR at www.sedar.com on June 2, 2014. The key commercial terms of the facility were: an original maturity date of August 30, 2014 (subsequently extended); an interest rate of one month US dollar LIBOR Rate in effect plus 11% per annum; a commitment fee of 35% of interest rate payable quarterly in arrears on undrawn principal amount of facility and a front end fee of $0.1 million.

During 2014 and 2015, the due date of the TRQ Loan, was extended several times and the credit limit has been reduced to $3.8 million.

On May 16, 2016, the Company and Turquoise Hill entered into the May 2016 Deferral Agreement, whereby Turquoise Hill agreed to a limited and circumscribed deferral of repayment of all remaining amounts and obligations now and hereafter owing under the TRQ Loan to December 29, 2017 in accordance with the schedule of repayment set out below:

- The Company has agreed to effect monthly repayments on the last business day of each month in an amount of (i) $0.15 million per month starting on May 31, 2016 and ending on April 28, 2017, (ii) $0.2 million per month starting on May 31, 2017 and ending on December 29, 2017, and (iii) the remaining balance on December 29, 2017 (collectively (i) to (iii), the Repayments, and each, a Repayment). Upon receipt of each Repayment by Turquoise Hill, the aggregate amount of obligations owing under the TRQ Loan will be reduced by such equal amount;
- In the event that the Company fails to make any one of the Repayments in its entirety on or before the dates set out above, then the Company shall be in automatic and irremediable default of the obligations thereunder and under the TRQ Loan, shall immediately and irremediably lose all benefits of the May 2016 Deferral Agreement, and all then outstanding obligations shall become immediately due and payable to Turquoise Hill; and
- Interest shall continue to accrue on all outstanding obligations at 12-month US dollar LIBOR rate.

Under certain conditions, including the non-payment of interest amounts as the same become due, amounts outstanding under the TRQ Loan 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 TRQ Loan. Subject to notice and cure periods, certain events of default under the TRQ Loan will result in acceleration of the indebtedness under such loan at the option of Turquoise Hill.

At June 30, 2016, the outstanding principal and accrued interest under this facility amounted to $3.3 million and $0.7 million respectively (at December 31, 2015, the outstanding principal and accrued interest amounted to $3.4 million and $0.6 million respectively).

The amount due in May to July 2016 has been paid as at August 15, 2016.

Short-term bridge loan

On October 27, 2015, the Company executed a $10 million bridge loan agreement with an independent Asian based private equity fund. The interest rate is 8% per annum and payable upon the repayment of loan principal.

The Company repaid the first tranche of the short-term bridge loan of $4.5 million on July 26, 2016. During June and July 2016, the Company drew the second tranche of $5.0 million, $1.5 million and $3.5 million will mature in March and April 2017, respectively.

As at June 30, 2016, the outstanding balance for the short-term bridge loan was $6.0 million (December 31, 2015: $4.9 million) and the Company owed accrued interest of $0.2 million (December 31, 2015: $0.1 million).

Under certain conditions, including the non-payment of interest amounts as the same become due, amounts outstanding under the short-term bridge loan 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 short-term bridge loan. Subject to notice and cure periods, certain events of default under the short-term bridge loan will result in acceleration of the indebtedness under the short-term bridge loan at the option of the lender.

Bank loan

On May 6, 2016, the Company entered into a $2.0 million loan agreement with a Mongolian bank. The key commercial terms of the loan are as follows:

- Maturity on May 6, 2017;
- Interest rate of 15.8% per annum and payable monthly; and
- Certain items of property, plant and equipment of $4.6 million were pledged.

As at June 30, 2016, the outstanding balance for the bank loan was $2.0 million (December 31, 2015: nil) and the Company owed accrued interest of $0.3 million (December 31, 2015: nil).

Going concern considerations

The Company's condensed consolidated financial statements have been prepared on a going concern basis which assumes that the Company will continue operating until at least June 30, 2017 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 transactions to provide it with additional liquidity.

Several adverse conditions and material uncertainties cast significant doubt upon the going concern assumption. The Company had cash of $3.0 million at June 30, 2016 and the trade payables of the Company have started accumulating due to liquidity constraints. The aging profile has risen as compared to that as at December 31, 2015, as follows:

	As at	
	June 30, 2016	**December 31, 2015**
Less than 1 month	**$ 11,123**	$ 9,465
1 to 3 months	**2,787**	3,282
3 to 6 months	**4,858**	6,075
Over 6 months	**20,214**	12,095
Total trade and other payables	**$ 38,982**	$ 30,917

The Company may not be able to settle all trade and other payables on a timely basis while continuing postponement in settling the trade payables may impact the mining operations of the Company and may result in potential lawsuits and/or bankruptcy proceedings may be filed against the Company. No such lawsuits or proceedings are pending as at August 15, 2016.

The Company anticipates that coal prices in China will remain under pressure in 2016, which will continue to impact the Company's margins and liquidity. The Company has enhanced the previous funding plan, in which, in addition to minimizing uncommitted capital expenditures, securing additional financing (which includes working capital financing from vendors) and longer term coal offtake agreements by building direct sales relationships with end customers, the Company has been negotiating with key vendors to lengthen the credit terms and extend the payable turnover cycle. Further, the Company has been exploring the utilization of trade financing in order to speed up the receivable collection cycle.

The measures mentioned above are intended to allow the Company to ramp up production to capacity, meet existing as well as upcoming trade and other payables obligations and the interest due under the CIC Convertible Debenture, the short-term bridge loan, the TRQ Loan and the bank loan, to meet its obligations as they fall due and achieve its business objectives in 2016.

These obligations include the tax penalty due to the Government of Mongolia (Refer to "Governmental and Regulatory Investigations" of section 6 for details). However, there is no guarantee that the Company will be able to successfully execute the measures mentioned above and 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 June 30, 2017, 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 the cash interest payments due under the CIC Convertible Debenture, the short-term bridge loan, the TRQ Loan and the bank loan. 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. If the Company is unable to continue as a going concern it may be forced to seek relief under applicable bankruptcy and insolvency legislation. 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.

Continuing delay in securing additional financing could ultimately result in an event of default of the CIC Convertible Debenture, the short-term bridge loan, TRQ Loan and the bank loan, which if not cured within applicable cure periods in accordance with the terms of respective instruments, may result in the principal amounts owing and all accrued and unpaid interest becoming immediately due and payable upon notice to the Company by CIC, the lender of the short-term bridge loan, Turquoise Hill and the lender of the bank loan, respectively.

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 June 30, 2016, the Company had cash of $3.0 million compared to cash of $0.4 million as at December 31, 2015. The Company had a working capital deficiency (excess current liabilities over current assets) of $(147.5) million as at June 30, 2016 compared to $(42.3) million of working capital deficiency as at December 31, 2015. As at August 15, 2016, the Company had cash of $0.8 million.

As at June 30, 2016, the Company's gearing ratio was 0.01 (December 31, 2015: 0.33), which was calculated based on the Company's long term liabilities to total assets. As at June 30, 2016, the Company is not subject to any externally imposed capital requirements.

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 (CAD$11.88). As at June 30, 2016, the CIC owned, through its indirect wholly-owned subsidiary, approximately 19.4% of the issued and outstanding common shares of the Company.

On July 13, 2016, the Company executed a deferral agreement with CIC which covers outstanding deferred cash interest obligations and associated costs of $18.8 million as of July 13, 2016 and the next Issue Date Anniversary Cash Interest payment of $8.1 million due on November 19, 2016. Pursuant to the deferral agreement, the Company has agreed to repay $1.3 to $1.4 million monthly from July to November 2016 and repay $20.7 million on December 19, 2016. In consideration for the deferred payments, the Company will pay a deferral fee at a rate of 6.4% per annum to CIC.

Although CIC and the Company had finalized the terms of a deferral of CIC interest payments at the end of the second quarter, a formal written agreement had not been executed as at June 30, 2016. As a consequence, IAS 1 required the Company to classify the entire balance of the CIC Convertible Debenture as a current liability as at June 30, 2016, notwithstanding the fact that CIC had agreed to the terms of the deferral and had not indicated any intention to deliver notice of default or accelerate the maturity of the debenture. Following the execution of the deferral agreement on July 13, 2016, the CIC Convertible Debenture met the requirements of IAS 1. The Company anticipates that both the debt host and the fair value of the embedded derivative will be classified as a non-current liability going forward, unless a future event of default occurs under the terms of the CIC Convertible Debenture. The interest due in July 2016 has been paid as at August 15, 2016.

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.

Cash Flow Highlights

	Six months ended June 30	
$ in thousands	**2016**	**2015**
Cash generated from/(used in) operating activities	**$ 440**	$ (6,158)
Cash used in investing activities	**(994)**	(4,056)
Cash generated from financing activities	**3,109**	7,340
Effect of foreign exchange rate changes on cash	**53**	(14)
Increase/(decrease) in cash for the period	**2,608**	(2,888)
Cash balance, beginning of period	**377**	3,789
Cash balance, end of period	**$ 2,985**	$ 901

Cash generated from/(used in) Operating Activities

The Company generated $0.4 million of cash in operating activities in the first six months of 2016 compared to cash used in operating activities of $6.2 million in the first six months of 2015. The primary reason for the increase in cash generated from operating activities for the first six months of 2016 compared to the first six months of 2015 is due to increased sales during the period.

Cash used in Investing Activities

In the first six months of 2016, the Company used $1.0 million of cash in investing activities compared to $4.1 million in the first six months of 2015. The cash used in investing activities primarily related to capitalized deferred stripping expenditure included within property, plant and equipment.

Cash generated from Financing Activities

The cash generated from financing activities in the first six months of 2016 primarily related to the net drawdown of loans. In particular, $2 million has been drawn down from a new loan with a Mongolian bank. The cash generated for the first six months of 2015 primarily related to the proceeds from the private placement with Novel Sunrise for net proceeds of $7.3 million.

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 June 30, 2016, the Company's operating and capital commitments were:

	Within 1 year	2-3 years	Over 3 years	Total
As at June 30, 2016				
Capital expenditure commitments	**$ 4**	**$ -**	**$ -**	**$ 4**
Operating expenditure commitments	**4,178**	**1,086**	**481**	**5,745**
Commitments	**$ 4,182**	**$ 1,086**	**$ 481**	**$ 5,749**

The commitments for expenditure has decreased by $19.3 million compared to December 31, 2015, principally as a result of the cancellation of spare parts purchase contracts. Such cancellation is not expected to affect the mine operations.

Ovoot Tolgoi Mine Impairment Analysis

Unchanged from the assessment made in several prior quarters, the Company determined that an indicator of impairment existed for its Ovoot Tolgoi Mine cash generating unit as at June 30, 2016. The impairment indicator was the continued weakness in the Company's share price during the six months ended of 2016 and the fact that the market capitalization of the Company, as at June 30, 2016, was significantly 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 "fair value less cost of disposal" ("FVLCTD") 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, operating cost assumptions and life of mine coal production assumptions as at June 30, 2016. The Company's Ovoot Tolgoi Mine cash generating unit carrying value was $193 million as at June 30, 2016.

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

- Coal resources as estimated by a third party engineering firm;
- Long term price estimates from an independent market consulting firm;
- Forecasted sales volumes in line with production levels as per the updated 20-year mine plan;
- Updated life-of-mine coal production, strip ratio, capital costs and operating costs; and
- A post-tax discount rate of 13.9% based on an analysis of the market, country and asset specific factors.

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 $10.4/($10.4) million;
- For each 1% increase/(decrease) in the discount rate, the calculated fair value of the cash generating unit (decreases)/increases by approximately ($17.3)/$20.0 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 ($6.9)/$6.9 million.

The impairment analysis did not result in the identification of an impairment loss and no charge was required as at June 30, 2016. A decline of more than 1% in the long term price estimates, an increase of more than 1% in the post-tax discount rate or an increase of more than 1% 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.

Investment in RDCC LLC Impairment Analysis

At each reporting date, the Company reviews its investment in RDCC LLC to determine whether there are any indications of impairment. As at June 30, 2016, management of the Company determined that the current toll rate being lower than the rate per the concession agreement, constituted an impairment indicator. Therefore, the Company completed an impairment assessment for the investment in RDCC LLC whereby the carrying value of the investment was compared to its recoverable amount using assumptions consistent with those used at December 31, 2015. Management's impairment evaluation did not result in the identification or reversal of an impairment loss as at June 30, 2016.

6. REGULATORY ISSUES AND CONTINGENCIES

Governmental and Regulatory Investigations

In 2014, the Company was subject to several investigations by Mongolia's Independent Authority Against Corruption (the "IAAC"). See "REGULATORY ISSUES AND CONTINGENCIES – Governmental and Regulatory Investigations" in the Company's MD&A for the year ended December 31, 2015 available on SEDAR at www.sedar.com for further details.

In February 2015, the Mongolian Second District Criminal Court delivered a written verdict to the Company in respect of allegations of tax evasion by former employees of the Company (the "Tax Verdict"). The Tax Verdict pronounced the three former employees guilty and declared the Company's subsidiary SGS to be financially liable as a "civil defendant" for a penalty (the "Tax Penalty") of MNT35.3 billion (approximately $18.2 million on February 1, 2015). Following the refusal of the Supreme Court of Mongolia to hear the case on appeal in June 2015, the Tax Verdict has entered into force. The Tax Verdict is, however, not immediately payable and enforceable against SGS absent further actions prescribed by the laws of Mongolia. However, the Company made a corresponding provision for the court case penalty of $18.0 million in the second quarter of 2015 ($15.2 million as at June 30, 2016) given the Tax Verdict has entered into force.

On October 6, 2015, the Company was informed by its Mongolian banks (where the Restricted Funds were held) that they had received an official request from the Court Decision Implementing Agency of Mongolia ("CDIA") to transfer the Restricted Funds according to the court decision. $1.2 million was transferred to CDIA from the frozen bank accounts in October and November 2015.

During the second quarter of 2016, $1.5 million has been paid as a partial settlement of the Tax Penalty. The Company intends to make additional payments of $1.2 million and $3.8 million in 2016 and 2017, respectively.

The Company is currently seeking to resolve amicably the dispute giving rise to the Tax Verdict in a manner that is both appropriate having regard to the Company's limited financial resources and supportive of a positive environment for foreign investment in Mongolia. While negotiations with the Government of Mongolia have proceeded well to date, a final and binding resolution has not yet been reached, and further negotiations may be required in light of the change of government as a result of the Mongolian elections in June 2016. The Company continues to believe that an amicable solution can be reached. There can be no assurance, however, that any such resolution can ultimately be successfully negotiated by the Company either at all or on favourable terms, or that the terms of any resolution to which the Government would ultimately be prepared to agree would not be materially adverse to the Company. In such case, this may result in an event of default under each of the CIC Convertible Debenture and the TRQ Loan and CIC and Turquoise Hill would each have the right to declare the full principal and accrued interest owing to such party immediately due and payable. Such an event of default under the CIC Convertible Debenture, the TRQ Loan, or the Company's inability to pay the Tax Penalty could result in voluntary or involuntary proceedings involving the Company (including bankruptcy). For further information see the Risk Factor entitled "If the Tax Verdict is enforceable against SGS and the Tax Penalty is immediately payable the Company will likely not have sufficient cash resources to satisfy the penalty imposed thereunder" in the Company's MD&A for the year ended December 31, 2015 available on SEDAR at www.sedar.com.

The Company has provided $15.2 million for the court case penalty at June 30, 2016. The decrease from $18.0 million as at June 30, 2015 is as a result of subsequent transfers from frozen bank accounts of $1.2 million, additional cash payments by the Company of $1.5 million and foreign exchange adjustments.

Internal Investigations

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 allegations raised in the context of investigations by Mongolian authorities. The former Chair of the Audit Committee also participated in a tripartite committee, comprised of the Audit Committee Chairs of the Company and Turquoise Hill and a representative of Rio Tinto plc. ("Rio Tinto"), focused on the investigation of a number of those allegations, including possible violations of anti-corruption laws. The tripartite committee substantially completed the investigative stage 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 investigation 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 June 30, 2016 a provision for this matter is not required.

Mongolian IAAC investigation

In the first quarter of 2013, the Company was subject to orders imposed by the IAAC which placed restrictions on certain of the Company's Mongolian assets. The orders were imposed on the Company in connection with the IAAC's investigations of the Company as described above under "Governmental and Regulatory Investigations" and continued to be enforced by the Mongolian State Investigation Office. The restrictions on the assets were reaffirmed in the Tax Verdict and form part of the Tax Penalty payable by the Company.

The orders related 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 restricted the use of in-country funds but did not have any material impact on the Company's activities. The Restricted Funds were transferred to the Court Decision Implementing Agency of Mongolia as partial payment of the Tax Verdict in October and November 2015. See "*Governmental and Regulatory Investigations"* above.

Following a review by the Company and its advisers, it is the Company's view that the orders placing restrictions on certain of the Company's Mongolian assets did not result in an event of default as defined under the terms of the CIC Convertible Debenture. However, the enforcement of the orders could ultimately result in an event of default of the Company's CIC Convertible Debenture, which if it remains uncured for ten business days, would result in the principal amount owing and all accrued and unpaid interest will become immediately due and payable upon notice to the Company by CIC.

Class Action Lawsuit

In January, 2014, Siskinds LLP, a Canadian law firm, filed a class action (the "Class 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.

To commence and proceed with the Class Action, the plaintiff was required to bring the preliminary leave motion and to certify the Class Action as a class proceeding (the "Certification Motion"). The Court rendered its decision on the leave motion on November 5, 2015.

The Ontario Court dismissed the plaintiff's leave motion as against each of the former senior officers and former and current directors of the Company named in the Class Action on the basis that the "large volume of compelling evidence" proved the defense of reasonable investigation on the balance of probabilities and provided the basis for dismissing the Leave Motion as against them.

On May 24, 2016, the Ontario Superior Court of Justice granted the Company leave to appeal the decision made on November 5, 2015, which granted the plaintiff permission to commence an action claiming damages under the Ontario Securities Act with respect to the Company's restatement of financial statements as previously disclosed in the Company's public filings.

The plaintiff has also appealed. The Ontario Court of Appeal granted an adjournment of the plaintiff's original hearing date of June 27, 2016, pending the expected consolidation of the Divisional Court appeal brought on behalf of the Company. The parties have consented to a consolidation of the appeals in principle and are negotiating the terms of the Consent Order. It is expected that the Motion seeking consolidation on consent will be filed with the Court in August and the Court of Appeal will deal with the consolidation quickly. Assuming that the Court of Appeal will grant the consent order, the appeals will be perfected in September and heard together in the spring of 2017.

The Company disputes and is vigorously defending 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 Class Action or determine the amount of any potential losses, if any. However, the Company has judged a provision for this matter at June 30, 2016 is not required.

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.

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 $18.5 million. At each reporting date, the Company assesses the agreement with Ejin Jinda and has determined it is not probable that these $18.5 million will be required to be paid as part of the initial contract.

Special Needs Territory in Umnugobi

On February 13, 2015, the whole of the Soumber mining license and a portion of SGS' exploration license No.9443X (the "License Areas") were included into a special protected area (to be further referred as Special Needs Territory "SNT") newly set up by the Umnugobi Aimag's Civil Representatives Khural (the "CRKh") to establish a strict regime on the protection of natural environment and prohibit mining activities in the territory of the SNT.

On July 8, 2015, SGS and the Chairman of the CRKh, in his capacity as the respondent's representative, reached an agreement (the "Amicable Resolution Agreement") to exclude the License Areas from the territory of the SNT in full, subject to confirmation of the Amicable Resolution Agreement by the session of the CRKh. The parties formally submitted the Amicable Resolution Agreement to the appointed judge of the Administrative Court for her approval and requested a dismissal of the case in accordance with the Law of Mongolia on Administrative Court Procedure. On July 10, 2015, the judge issued her order approving the Amicable Resolution Agreement and dismissing the case, while reaffirming the obligation of CRKh to take necessary actions at its next session to exclude the License Areas from the SNT and register the new map of the SNT with the relevant authorities. Mining activities at the Soumber property cannot proceed until the License Areas are removed from the SNT.

On June 29, 2016, the Mongolian Parliament and Aimag's Civil Representatives Khural election was held. Thus the newly established CRKh will take necessary actions on SNT. The Company has not yet received any indication on the timing of the next session of the CRKh.

Commercial arbitration in Hong Kong

On June 24, 2015, First Concept served a notice of arbitration (the "Notice") on SGS in respect of a coal supply agreement dated May 19, 2014 as amended on June 27, 2014 (the "Coal Supply Agreement") for a total consideration of $11.5 million. The arbitral proceedings (the "Arbitration") are deemed to have commenced on June 24, 2015, as the date when the respondent received the Notice.

The Company firmly rejects the allegations of First Concept in the Notice as lacking any merit. On October 26, 2015, the Company received the Statement of Claim from First Concept and will vigorously defend itself in the Arbitration, including claiming the relevant fees and damages from First Concept. The trial dates of the Arbitration are scheduled to be held in the fourth quarter of 2016.

There can be no assurance, however, that the Company will prevail in the Arbitration. Should SGS be unsuccessful in the Arbitration, the Company may not be able to re-pay the sum of $11.5 million. In such case, this may result in an event of default under the CIC Convertible Debenture and CIC would have the right to declare the full principal and accrued interest owing thereunder immediately due and payable. Such an event of default under the CIC Convertible Debenture or the Company's inability to re-pay the sum of $11.5 million to First Concept could result in voluntary or involuntary proceedings involving the Company (including bankruptcy). See Risk Factors in the Company's MD&A for the year ended December 31, 2015 available on SEDAR at www.sedar.com.

Notice of claim by former Chief Executive Officer

On June 30, 2015, the Company was served with a Notice of Civil Claim filed by the Company's former President and Chief Executive Officer, Alexander Molyneux, in the British Columbia Supreme Court. The claim relates to alleged breaches of Mr. Molyneux's employment agreement by the Company. In addition to the Company, Turquoise Hill, the Company's largest shareholder at the time of Mr. Molyneux's employment, was also named in the claim.

Mr. Molyneux acted as the Company's President (from April 2009) and Chief Executive Officer (from October 2009) until September 2012, when the Company terminated his employment.

Mr. Molyneux is seeking damages in excess of $1 million in his Notice of Claim. SouthGobi reserves its right to pursue all legal rights and remedies available to it in connection with the proceedings. The Company filed a response to Civil Claim and Counterclaim in September 2015. A trial date has not yet been set.

7. RELATED PARTY TRANSACTIONS

The Company had related party transactions during the six months ended June 30, 2015 with the following companies related by way of directors or shareholders in common:

- Turquoise Hill – Turquoise Hill provided various administrative services to the Company on commercial terms.
- Rio Tinto – Rio Tinto controlled Turquoise Hill. The Company recovered administration and other costs incurred on behalf of Rio Tinto on a cost-recovery basis. Rio Tinto recovered from the Company the costs of salaries and benefits of employees assigned to work for the Company and recovered legal and professional fees from the Company in respect of the internal and tripartite committees.
- Turquoise Hill Resources Singapore Pte. Ltd. ("Turquoise Hill Singapore") – Turquoise Hill Singapore is a private company 100% owned by Turquoise Hill. Turquoise Hill Singapore provided information technology and other related services to the Company on a cost-recovery basis.

During the year ended December 31, 2015 the ownership of Turquoise Hill and its ultimate parent, Rio Tinto, in the Company declined below 20% and Turquoise Hill ceased to have significant influence, as defined by IFRS, over the operations of the Company. Accordingly, commencing January 1, 2016 transactions between the Company and Turquoise Hill and Rio Tinto no longer meet the definition of a related party transaction.

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

		Three months ended June 30, 2015
Corporate administration	$	130
Salaries and benefits		204
Finance costs		107
Related party expenses	$	441

		Six months ended June 30, 2015
Corporate administration	$	211
Salaries and benefits		144
Finance costs		213
Related party expenses	$	568

		Three months ended June 30, 2015
Turquoise Hill	$	107
Rio Tinto		251
Turquoise Hill Singapore		83
Related party expenses	$	441

		Six months ended June 30, 2015
Turquoise Hill	$	212
Rio Tinto		192
Turquoise Hill Singapore		164
Related party expenses	$	568

8. OUTSTANDING SHARE DATA

The Company is authorized to issue an unlimited number of Common Shares without par value and an unlimited number of preferred shares without par value. As at August 15, 2016, 257.7 million Common Shares were issued and outstanding. There are also incentive share options outstanding to acquire 1.8 million unissued Common Shares with exercise prices ranging from CAD$0.29 to CAD$6.16. There are no preferred shares outstanding.

On April 15, 2016, Novel Sunrise entered into an Option Agreement (the "Option Agreement") with Voyage Wisdom Limited ("Voyage Wisdom"), a private company owned by Messrs. Ningqiao Li, Aminbuhe and Yulan Guo, (collectively, the "VWL Shareholders"), pursuant to which Novel Sunrise granted Voyage Wisdom an option to purchase from Novel Sunrise (the "Call Option"), and Voyage Wisdom granted Novel Sunrise an option to sell to Voyage Wisdom (the "Put Option"), 25.8 million common shares of the Company currently owned by Novel Sunrise, free and clear of encumbrances, for a total purchase price of $24 million, payable in cash. The Option Agreement provides that the Call Option and Put Option (together, the "Options") may be exercised by Voyage Wisdom and Novel Sunrise, respectively, in whole but not in part, at any time prior to April 21, 2016 or such later date as the parties may agree in writing, but in no event later than October 21, 2016. The effective date of the Option Agreement was extended to October 21, 2016 on April 21, 2016.

As at August 15, 2016, Novel Sunrise holds a total of approximately 72.1 million Common Shares representing approximately 28.0% of the issued and outstanding Common Shares.

As at August 15, 2016, CIC holds a total of 49.9 million Common Shares representing approximately 19.4% of the issued and outstanding Common Shares.

As at August 15, 2016, Turquoise Hill directly owned approximately 33.5 million Common Shares representing approximately 13.0% of the issued and outstanding Common Shares.

9. INTERNAL CONTROLS OVER FINANCIAL REPORTING

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.

10. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The preparation of financial statements in conformity with IFRS requires the Company to establish accounting policies and to make 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, 2015. Please refer to note 3.22 of the Company's December 31, 2015 consolidated financial statements for information regarding the accounting judgments and estimates that have the most significant effect on the amounts recognized in the Company's consolidated financial statements. These significant accounting judgments and estimates remain unchanged from December 31, 2015.

11. RISK FACTORS

There are certain risks involved in the Company's operations, some of which are beyond its control. Material risks and uncertainties affecting the Company, their potential impact and the Company's principal risk management strategies are, except as updated by this MD&A, substantially unchanged from those disclosed in the Company's MD&A for the year ended December 31, 2015, which are available at www.sedar.com.

12. OUTLOOK

Market conditions and prices for coal remained weak in China during the first half of 2016 despite modest recovery of the general coal market in China following implementation of China's national policy to reduce its coal production to accelerate supply-side reform to resolve the overcapacity issue in the medium term.

The Company will continue to reach out to end customers in order to enhance the sales profile and revenue growth.

In addition, the Company will continue to examine ways to improve operational efficiency and productivity to reduce costs. The Company is also evaluating various other business opportunities in addition to coal mining and trading in Mongolia to diversify the risk profile.

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

- **Bridge between Mongolia and China** – The Company is well positioned to capture the resulting business opportunities between the two countries given i) strong strategic support from its largest shareholders (China Cinda Asset Management Corporation Limited and CIC), which are both state-owned-enterprises in China; and ii) the Company's strong operational record during the last ten years in Mongolia and being one of the largest enterprises in Mongolia.

- **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** – Following the updated mineral resource estimate for the Ovoot Tolgoi Project, the Company's aggregate coal resources include measured and indicated resources of 365 million tonnes and inferred resources of 285 million tonnes. In addition, most of the Company's coal resources have coking properties, including a mixture of semi-soft coking coal and hard coking coal.

- **Several growth options** – The Company has several growth options including the Soumber Deposit and Zag Suuj Deposit, located approximately 20km east and approximately 150km east of the Ovoot Tolgoi Mine, respectively.

Objectives

The Company's objectives for 2016 and the medium term are as follows:

- Expand customer base with enhanced product mix – The Company aims to strengthen the sales and logistics capabilities to expand the customer base further inland in China and to beneficiate the coal by washing.

- Optimize cost structure – The Company is focused on further cost reduction by improving productivity and operational efficiency while maintaining product quality and the sustainability of production.

- Progress growth options – Subject to available financial resources, the Company plans to further the development of the Soumber Deposit, while complying with all government requirements in relation to its licenses and agreements.

- Diversify the risk profile of the Company – The Company is evaluating various business opportunities besides coal mining and coal trading in Mongolia, including but not limited to power generation, contract mining and real estate. The Company aims to bridge into the new era of Mongolia prosperity committed to contribute to the long term development of Mongolia.

- Operate in a socially responsible manner – The Company is focused on maintaining the highest standards in health, safety and environmental performance.

August 15, 2016

SouthGobi Resources Ltd.
Condensed Consolidated Interim Financial Statements

June 30, 2016
(Expressed in U.S. Dollars)
(Unaudited)

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NOTES TO THE CONDENSED FINANCIAL STATEMENTS

ADDITIONAL STOCK EXCHANGE INFORMATION

SOUTHGOBI RESOURCES LTD.

Condensed Consolidated Interim Statement of Comprehensive Income

(Unaudited)

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

	Notes	Three months ended June 30, 2016	Three months ended June 30, 2015	Six months ended June 30, 2016	Six months ended June 30, 2015
Revenue		**$ 10,361**	$ 2,951	**$ 23,088**	$ 4,536
Cost of sales	4	**(23,105)**	(11,835)	**(42,185)**	(29,511)
Gross loss		**(12,744)**	(8,884)	**(19,097)**	(24,975)
Other operating income/(expenses)	5	**812**	(19,450)	**(899)**	(18,479)
Administration expenses	6	**(1,826)**	(1,961)	**(3,468)**	(3,388)
Evaluation and exploration expenses		**(52)**	22	**(99)**	(56)
Loss from operations		**(13,810)**	(30,273)	**(23,563)**	(46,898)
Finance costs	7	**(5,377)**	(5,222)	**(10,845)**	(11,605)
Finance income	7	**324**	273	**296**	16
Share of earnings of a joint venture	11	**256**	151	**339**	133
Loss before tax		**(18,607)**	(35,071)	**(33,773)**	(58,354)
Current income tax expense		**(23)**	(1)	**(258)**	(1)
Net loss attributable to equity holders of the Company		**(18,630)**	(35,072)	**(34,031)**	(58,355)
Other comprehensive income to be reclassified to profit or loss in subsequent periods					
Exchange difference on translation of foreign operation		**879**	-	**367**	-
Net comprehensive loss attributable to equity holders of the Company		**$ (17,751)**	$ (35,072)	**$ (33,664)**	$ (58,355)
Basic and diluted loss per share		**$ (0.07)**	$ (0.15)	**$ (0.13)**	$ (0.25)

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

SOUTHGOBI RESOURCES LTD.

Condensed Consolidated Interim Statement of Financial Position

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

	Notes	As at June 30, 2016	As at December 31, 2015
Assets			
Current assets			
Cash and cash equivalents		**$ 2,985**	$ 377
Trade and other receivables	8	**13,628**	8,196
Inventories	9	**27,199**	32,262
Prepaid expenses and deposits		**4,223**	1,487
Total current assets		**48,035**	42,322
Non-current assets			
Property, plant and equipment	10	**201,192**	222,485
Investment in a joint venture	11	**25,884**	25,667
Total non-current assets		**227,076**	248,152
Total assets		**$ 275,111**	$ 290,474
Equity and liabilities			
Current liabilities			
Trade and other payables	12	**$ 38,982**	$ 30,917
Provision for court case penalty		**15,219**	16,468
Deferred revenue		**14,343**	11,683
Interest-bearing borrowings	13	**12,112**	8,905
Current portion of convertible debenture	14	**114,888**	16,671
Total current liabilities		**195,544**	84,644
Non-current liabilities			
Convertible debenture	14	**-**	91,988
Decommissioning liability		**2,543**	3,149
Total non-current liabilities		**2,543**	95,137
Total liabilities		**198,087**	179,781
Equity			
Common shares	15	**1,094,619**	1,094,618
Share option reserve		**52,286**	52,292
Exchange reserve		**(908)**	(1,275)
Accumulated deficit	15	**(1,068,973)**	(1,034,942)
Total equity		**77,024**	110,693
Total equity and liabilities		**$ 275,111**	$ 290,474
Net current liabilities		**$ (147,509)**	$ (42,322)
Total assets less current liabilities		**$ 79,567**	$ 205,830

Corporate information and going concern (Note 1), commitments for expenditure (Note 20) and contingencies (Note 21)

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

APPROVED BY THE BOARD:

"Mao Sun"
Director

"Yulan Guo"
Director

SOUTHGOBI RESOURCES LTD.

Condensed Consolidated Interim Statement of Changes in Equity

(Unaudited)

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

	Number of shares/units	Share capital	Share option reserve	Exchange fluctuation reserve	Accumulated deficit	Total
Balances, January 1, 2015	218,752	$ 1,080,417	$ 52,041	$ -	$ (848,177)	$ 284,281
Shares issued for:						
Private placement	11,619	3,812	-	-	-	3,812
Exercise of stock options, net of redemptions	12	9	(3)	-	-	6
Employee share purchase plan	5	3	-	-	-	3
Conversion of mandatory convertible units	10,131	3,518	-	-	-	3,518
Share-based compensation charged to operations	-	-	186	-	-	186
Net loss for the period	-	-	-	-	(58,355)	(58,355)
Balances, June 30, 2015	240,519	$ 1,087,759	$ 52,224	$ -	$ (906,532)	$ 233,451
Balances, January 1, 2016	**257,683**	**$ 1,094,618**	**$ 52,292**	**$ (1,275)**	**$ (1,034,942)**	**$ 110,693**
Shares issued for:						
Employee share purchase plan	**11**	**1**	**-**	**-**	**-**	**1**
Share-based compensation credited to operations	**-**	**-**	**(6)**	**-**	**-**	**(6)**
Net loss for the period	**-**	**-**	**-**	**-**	**(34,031)**	**(34,031)**
Exchange differences on translation of foreign operations	**-**	**-**	**-**	**367**	**-**	**367**
Balances, June 30, 2016	**257,694**	**$ 1,094,619**	**$ 52,286**	**$ (908)**	**$ (1,068,973)**	**$ 77,024**

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

SOUTHGOBI RESOURCES LTD.

Condensed Consolidated Interim Statement of Cash Flows

(Unaudited)

(Expressed in thousands of U.S. Dollars)

		Six months ended June 30,	
	Notes	**2016**	**2015**
Operating activities			
Loss before tax		**$ (33,773)**	$ (58,354)
Adjustments for:			
Depreciation and depletion		**18,723**	17,447
Share-based (recovery)/compensation	16	**(6)**	186
Finance costs	7	**10,845**	11,605
Finance income	7	**(296)**	(16)
Share of earnings of a joint venture	11	**(339)**	(133)
Interest paid		**(4,037)**	-
Income tax paid		**(54)**	(2)
Unrealized foreign exchange loss/(gain)		**555**	(160)
Loss on disposal of property, plant and equipment		**-**	(6)
Provision for doubtful trade and other receivables	8	**2**	157
Impairment of inventories	9	**5,706**	3,111
Operating cash flows before changes in non-cash working capital items		**(2,674)**	(26,165)
Net change in non-cash working capital items	19	**3,114**	20,007
Cash generated from/(used in) operating activities		**440**	(6,158)
Investing activities			
Expenditures on property, plant and equipment		**(1,485)**	(4,028)
Interest received		**2**	2
Investment in a joint venture		**-**	(30)
Dividend from a joint venture	11	**489**	-
Cash used in investing activities		**(994)**	(4,056)
Financing activities			
Proceeds from issuance of common shares		**1**	7,340
New loans		**3,520**	-
Repayment of interest-bearing loans		**(412)**	-
Cash generated from financing activities		**3,109**	7,340
Effect of foreign exchange rate changes on cash		**53**	(14)
Increase/(decrease) in cash		**2,608**	(2,888)
Cash, beginning of period		**377**	3,789
Cash, end of period		**$ 2,985**	$ 901

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

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 June 30, 2016, Novel Sunrise Investments Limited ("Novel Sunrise"), a wholly-owned subsidiary of China Cinda (HK) Investments Management Company Limited ("Cinda"), owned approximately 28% of the outstanding Common Shares of the Company. China Investment Corporation ("CIC") and Turquoise Hill Resources Ltd. ("Turquoise Hill") owned approximately 19% and 14% of the outstanding Common Shares of the Company, respectively.

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.

In June 2016, as part of the Company's strategy to expand the sales channels of coal in China, the Company incorporated a 100%-owned subsidiary in China, Inner Mongolia SouthGobi Energy Limited.

The head office, principal address and registered and records office of the Company is located at 1100 - 355 Burrard Street, Vancouver, British Columbia, Canada, V6C 2G8.

<u>Going concern assumption</u>

The Company's condensed consolidated interim financial statements have been prepared on a going concern basis which assumes that the Company will continue operating until at least June 30, 2017 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 transactions to provide it with additional liquidity.

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

1. CORPORATE INFORMATION AND GOING CONCERN (CONTINUED)

Several adverse conditions and material uncertainties cast significant doubt upon the going concern assumption. The Company had cash of $2,985 at June 30, 2016 and the trade payables of the Company have started accumulating due to liquidity constraints. The aging profile has risen as compared to that as at December 31, 2015, as follows:

	As at	
	June 30, 2016	**December 31, 2015**
Less than 1 month	**$ 11,123**	$ 9,465
1 to 3 months	**2,787**	3,282
3 to 6 months	**4,858**	6,075
Over 6 months	**20,214**	12,095
Total trade and other payables	**$ 38,982**	$ 30,917

The Company may not be able to settle all trade and other payables on a timely basis while continuing postponement in settling the trade payables may impact the mining operations of the Company and result in potential lawsuits and/or bankruptcy proceedings may be filed against the Company. No such lawsuits or proceedings are pending as at August 15, 2016.

The Company anticipates that coal prices in China will remain under pressure in 2016, which will continue to impact the Company's margins and liquidity. The Company has enhanced the previous funding plan, in which, in addition to minimizing uncommitted capital expenditures, securing additional financing (which includes working capital financing from vendors) and longer term coal offtake agreements by building direct sales relationships with end customers, the Company has been negotiating with key vendors to lengthen the credit terms and extend the payable turnover cycle. Further, the Company has been exploring the utilization of trade financing in order to speed up the receivable collection cycle.

The measures mentioned above are intended to allow the Company to ramp up production to capacity, meet existing as well as upcoming trade and other payables obligations and the interest due under the CIC Convertible Debenture, the short-term bridge loan, the TRQ Loan and the bank loan, to meet its obligations as they fall due and achieve its business objectives in 2016.

These obligations include the tax penalty due to the Government of Mongolia (Refer to "Governmental and Regulatory Investigations" of Note 21.1 for details). However, there is no guarantee that the Company will be able to successfully execute the measures mentioned above and 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 June 30, 2017, 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 the cash interest payments due under the CIC Convertible Debenture, the short-term bridge loan, the TRQ Loan and the bank loan. 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. If the Company is unable to continue as a going concern it may be forced to seek relief under applicable bankruptcy and insolvency legislation. 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.

1. CORPORATE INFORMATION AND GOING CONCERN (CONTINUED)

Continuing delay in securing additional financing could ultimately result in an event of default of the CIC Convertible Debenture, the short-term bridge loan, TRQ Loan and the bank loan, which if not cured within applicable cure periods in accordance with the terms of respective instruments, may result in the principal amounts owing and all accrued and unpaid interest becoming immediately due and payable upon notice to the Company by CIC, the lender of the short-term bridge loan, Turquoise Hill and the lender of the bank loan, respectively.

2. BASIS OF PREPARATION

2.1 Statement of compliance

These condensed consolidated interim financial statements, including comparatives, have been prepared in accordance with International Accounting Standard 34 "Interim Financial Reporting" 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 condensed consolidated interim financial statements of the Company for the six months ended June 30, 2016 were approved and authorized for issue by the Board of Directors of the Company on August 15, 2016.

2.2 Basis of presentation

These condensed consolidated interim financial statements have been prepared using accounting policies and methods of computation consistent with those applied in the Company's December 31, 2015 consolidated annual financial statements, except for those accounting policies which have changed as a result of the adoption of new and revised standards and interpretations as described below. These condensed consolidated interim financial statements do not include all the information and note disclosures required by IFRS for annual financial statements and therefore should be read in conjunction with the Company's annual consolidated financial statements for the year ended December 31, 2015.

2.3 Adoption of new and revised standards and interpretations

There were no new or revised IASB standards and interpretations adopted by the Company on January 1, 2016. There have been no other new IFRSs or IFRIC interpretations that are not yet effective that would be expected to have a material impact on the Company, except those disclosed in the Company's annual consolidated financial statements for the year ended December 31, 2015.

2.4 Significant accounting judgments and estimates

Information about judgments and estimates in applying accounting policies that have the most significant effect on the amounts recognized in the Company's consolidated financial statements are included in Note 3.22 to the Company's December 31, 2015 consolidated annual financial statements. Except for the significant accounting judgments and estimates disclosed below, the significant accounting judgments and estimates remain substantially unchanged from December 31, 2015.

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 as well as the expected timing of payments of suppliers and the repayment of debt and other financial liabilities. Refer to Note 1 for details.

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 CIC Convertible Debenture, the short-term bridge loan, the TRQ Loan and the bank loan, which if not cured within applicable cure periods in accordance with the terms of such instruments, may result in the principal amounts owing and all accrued and unpaid interest becoming immediately due and payable upon notice to the Company by CIC, the lender of the short-term bridge loan, Turquoise Hill and the lender of the bank loan, respectively.

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 of disposal 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.

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 June 30, 2016. The impairment indicator was the continued weakness in the Company's share price during the six months ended June 30, 2016 and the fact that the market capitalization of the Company, as at June 30, 2016, was significantly 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 "fair value less costs of disposal" ("FVLCTD") using a discounted future cash flow valuation model. The Company's cash flow valuation model takes into consideration the latest available information to the Company, including but not limited to, sales price, sales volumes, operating cost and life of mine coal production assumptions as at June 30, 2016. The Company's Ovoot Tolgoi Mine cash generating unit carrying value was $193,000 as at June 30, 2016.

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

- Coal resources as estimated by a third party engineering firm;
- Long term price estimates from an independent market consulting firm;
- Forecasted sales volumes in line with production levels as per the updated 20-year mine plan;
- Updated life-of-mine coal production, strip ratio, capital costs and operating costs; and
- A post-tax discount rate of 13.9% based on an analysis of the market, country and asset specific factors.

2. BASIS OF PREPARATION (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 $10,400/($10,400);
- For each 1% increase/(decrease) in the discount rate, the calculated fair value of the cash generating unit (decreases)/increases by approximately ($17,300)/$20,000; 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 ($6,900)/$6,900.

The impairment analysis did not result in the identification of an impairment loss and no charge was required as at June 30, 2016. 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 1% 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.

Investment in RDCC LLC

At each reporting date, the Company reviews its investment in RDCC LLC to determine whether there are any indications of impairment. As at June 30, 2016, management of the Company determined that the current toll rate being lower than the rate per the concession agreement, constituted an impairment indicator. Therefore, the Company completed an impairment assessment for the investment in RDCC LLC whereby the carrying value of the investment was compared to its recoverable amount using assumptions consistent with those used at December 31, 2015. Management's impairment evaluation did not result in the identification or reversal of an impairment loss as at June 30, 2016.

3. SEGMENTED INFORMATION

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

During the six months ended June 30, 2016, the Coal Division had 3 active customers with the largest customer accounting for 97% of revenues and the other customers accounting for the remaining 3% of revenue.

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

3. SEGMENTED INFORMATION (CONTINUED)

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

	Coal Division	Unallocated [i]	Consolidated Total
Segment assets			
As at June 30, 2016	**$ 273,597**	**$ 1,514**	**$ 275,111**
As at December 31, 2015	288,974	1,500	290,474
Segment liabilities			
As at June 30, 2016	**$ 58,578**	**$ 139,509**	**$ 198,087**
As at December 31, 2015	51,404	128,377	179,781
Segment revenues			
For the three months ended June 30, 2016	**$ 10,361**	**$ -**	**$ 10,361**
For the three months ended June 30, 2015	2,951	-	2,951
For the six months ended June 30, 2016	**$ 23,088**	**$ -**	**$ 23,088**
For the six months ended June 30, 2015	4,536	-	4,536
Segment loss			
For the three months ended June 30, 2016	**$ (11,776)**	**$ (6,854)**	**$ (18,630)**
For the three months ended June 30, 2015	(28,676)	(6,396)	(35,072)
For the six months ended June 30, 2016	**$ (20,115)**	**$ (13,916)**	**$ (34,031)**
For the six months ended June 30, 2015	(44,365)	(13,990)	(58,355)
Impairment charge/(reversal of impairment) on assets [ii] [iii]			
For the three months ended June 30, 2016	**$ 1,640**	**$ -**	**$ 1,640**
For the three months ended June 30, 2015	2,718	-	2,718
For the six months ended June 30, 2016	**$ 5,708**	**$ -**	**$ 5,708**
For the six months ended June 30, 2015	3,268	-	3,268
Depreciation and amortization			
For the three months ended June 30, 2016	**$ 11,513**	**$ 44**	**$ 11,557**
For the three months ended June 30, 2015	12,933	1	12,934
For the six months ended June 30, 2016	**$ 23,156**	**$ 71**	**$ 23,227**
For the six months ended June 30, 2015	24,964	12	24,976
Share of earnings of a joint venture			
For the three months ended June 30, 2016	**$ 256**	**$ -**	**$ 256**
For the three months ended June 30, 2015	151	-	151
For the six months ended June 30, 2016	**$ 339**	**$ -**	**$ 339**
For the six months ended June 30, 2015	133	-	133

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

3. SEGMENTED INFORMATION (CONTINUED)

	Coal Division	Unallocated (i)	Consolidated Total
Finance cost			
For the three months ended June 30, 2016	**$ 75**	**$ 5,302**	**$ 5,377**
For the three months ended June 30, 2015	133	5,089	5,222
For the six months ended June 30, 2016	**$ 104**	**$ 10,741**	**$ 10,845**
For the six months ended June 30, 2015	265	11,341	11,605
Finance income			
For the three months ended June 30, 2016	**$ 324**	**$ -**	**$ 324**
For the three months ended June 30, 2015	7	266	273
For the six months ended June 30, 2016	**$ 293**	**$ 3**	**$ 296**
For the six months ended June 30, 2015	14	2	16
Current income tax			
For the three months ended June 30, 2016	**$ 23**	**$ -**	**$ 23**
For the three months ended June 30, 2015	1	-	1
For the six months ended June 30, 2016	**$ 258**	**$ -**	**$ 258**
For the six months ended June 30, 2015	1	-	1

(i) The unallocated amount contains all amounts associated with the Corporate Division.
(ii) The impairment charges/(reversal of impairment) on assets for the three and six months ended June 30, 2016 relate to trade and other receivables (Note 8) and inventories (Note 9).
(iii) The impairment charge on assets for the three and six months ended June 30, 2015 related to trade and other receivables (Note 8) and inventories (Note 9).

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

	Mongolia	Hong Kong	Canada	China	Consolidated Total
Revenues					
For the three months ended June 30, 2016	**$ 10,361**	**$ -**	**$ -**	**$ -**	**$ 10,361**
For the three months ended June 30, 2015	2,951	-	-	-	2,951
For the six months ended June 30, 2016	**$ 23,088**	**$ -**	**$ -**	**$ -**	**$ 23,088**
For the six months ended June 30, 2015	4,536	-	-	$ -	4,536
Non-current assets					
As at June 30, 2016	**$ 226,681**	**$ 95**	**$ 100**	**$ 200**	**$ 227,076**
As at December 31, 2015	248,026	26	100	$ -	248,152

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

4. COST OF SALES

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

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Operating expenses	**$ 10,488**	$ 4,571	**$ 18,533**	$ 6,498
Share-based compensation expense/(recovery) (Note 16)	**(3)**	4	**(8)**	32
Depreciation and depletion	**6,253**	832	**9,832**	1,141
Impairment of coal stockpile inventories (Note 9)	**3,549**	2,561	**5,706**	3,111
Cost of sales from mine operations	**20,287**	7,968	**34,063**	10,782
Cost of sales related to idled mine assets (i)	**2,818**	3,867	**8,122**	18,729
Cost of sales	**$ 23,105**	$ 11,835	**$ 42,185**	$ 29,511

(i) Cost of sales related to idled mine assets for the three months ended June 30, 2016 includes $2,818 of depreciation expense (2015: includes $3,867 of depreciation expenses). Cost of sales related to idled mine assets for the six months ended June 30, 2016 includes $8,122 of depreciation expense (2015: includes $15,755 of depreciation expenses). The depreciation expense relates to the Company's idled plant and equipment.

Cost of inventories recognized as expense in cost of sales for the three months ended June 30, 2016 totaled $14,105 (2015: $2,144). Cost of inventories recognized as expense in cost of sales for the six months ended June 30, 2016 totaled $24,046 (2015: $3,927).

5. OTHER OPERATING INCOME/(EXPENSES)

The Company's other operating income/(expenses) consist of the following amounts:

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Foreign exchange loss	**$ 1,786**	1,196	**$ 1,514**	138
(Reversal of provision)/provision for doubtful trade and other receivables (Note 8)	**(1,909)**	157	**2**	157
Provision for court case penalty (Note 21.1)	**-**	18,049	**-**	18,049
Discount on settlement of trade payables	**(1,009)**	-	**(1,009)**	-
Other	**320**	48	**392**	135
Other operating (income)/expenses	**$ (812)**	$ 19,450	**$ 899**	$ 18,479

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

6. ADMINISTRATION EXPENSES

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

	Three months ended June 30,		Six months ended June 30,	
	2016	**2015**	**2016**	**2015**
Corporate administration	**$ 693**	$ 512	**$ 1,158**	$ 958
Professional fees	**391**	890	**895**	1,365
Salaries and benefits	**677**	472	**1,320**	852
Share-based compensation expense (Note 16)	**12**	47	**5**	147
Depreciation	**53**	40	**90**	66
Administration expenses	**$ 1,826**	$ 1,961	**$ 3,468**	$ 3,388

7. FINANCE COSTS AND INCOME

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

	Three months ended, June 30,		Six months ended, June 30,	
	2016	**2015**	**2016**	**2015**
Unrealized loss on embedded derivatives in convertible debenture (Note 14)	**$ -**	$ -	**$ -**	$ 1,279
Interest expense on convertible debenture (Note 14)	**5,274**	5,089	**10,522**	10,061
Interest expense on borrowings (Note 13)	**81**	107	**272**	213
Accretion of decommissioning liability	**22**	26	**51**	52
Finance costs	**$ 5,377**	$ 5,222	**$ 10,845**	$ 11,605

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

	Three months ended, June 30,		Six months ended, June 30,	
	2016	**2015**	**2016**	**2015**
Unrealized gain on embedded derivatives in convertible debenture (Note 14)	**$ 322**	$ 265	**$ 293**	$ -
Interest income	**2**	8	**3**	16
Finance income	**$ 324**	$ 273	**$ 296**	$ 16

8. TRADE AND OTHER RECEIVABLES

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

	As at	
	June 30, 2016	**December 31, 2015**
Trade receivables	**$ 13,144**	$ 7,800
Other receivables	**484**	396
Total trade and other receivables	**$ 13,628**	$ 8,196

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

8. TRADE AND OTHER RECEIVABLES (CONTINUED)

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

	As at	
	June 30, 2016	**December 31, 2015**
Less than 1 month	**$ 4,416**	$ 4,399
1 to 3 months	**6,577**	167
3 to 6 months	**2,513**	3,597
Over 6 months	**122**	33
Total trade and other receivables	**$ 13,628**	$ 8,196

Trade receivables are normally paid within 6 months from the date of billing. Overdue balances are reviewed regularly by senior management. The Company does not hold any collateral or other credit enhancements over its trade and other receivable balances.

For the three months ended June 30, 2016, the Company recorded a reversal of provision of $1,909 on its trade and other receivables in other operating expenses as a result of collecting certain long aged receivables (2015: provision of $157). For the six months ended June 30, 2016, the Company recorded a $2 provision on its trade and other receivables in other operating expenses (2015: $157). The Company anticipates full recovery of its remaining outstanding trade and other receivables; therefore, no further provisions have been recorded in respect of the Company's trade and other receivables.

9. INVENTORIES

The Company's inventories consist of the following amounts:

	As at	
	June 30, 2016	**December 31, 2015**
Coal stockpiles	**$ 4,767**	$ 9,606
Materials and supplies	**22,432**	22,656
Total inventories	**$ 27,199**	$ 32,262

Cost of sales for the three months and six months ended June 30, 2016 includes an impairment loss of $4,281 and $6,438, respectively, related to the Company's coal stockpile inventories (For three and six months ended June 2015: $2,561 and $3,111, respectively). As at June 30, 2016, $4,005 of the Company's coal stockpile inventories are carried at their net realizable value (December 31, 2015: $1,711).

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

10. 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 January 1, 2016	$ 369,317	$ 28,534	$ 72,194	$ 145,270	$ 4,079	$ 619,394
Additions	**358**	**266**	**-**	**1,968**	**-**	**2,592**
Disposals	**(632)**	**(13)**	**-**	**-**	**-**	**(645)**
As at June 30, 2016	**$ 369,043**	**$ 28,787**	**$ 72,194**	**$ 147,238**	**$ 4,079**	**$ 621,341**
Accumulated depreciation and impairment charges						
As at January 1, 2016	$ (230,475)	$ (26,772)	$ (42,056)	$ (93,733)	$ (3,873)	$ (396,909)
Charge for the period	**(19,628)**	**(535)**	**(2,358)**	**(706)**	**-**	**(23,227)**
Eliminated on disposals	**-**	**(13)**	**-**	**-**	**-**	**(13)**
As at June 30, 2016	**$ (250,103)**	**$ (27,320)**	**$ (44,414)**	**$ (94,439)**	**$ (3,873)**	**$ (420,149)**
Carrying amount						
As at December 31, 2015	$ 138,842	$ 1,762	$ 30,138	$ 51,537	$ 206	$ 222,485
As at June 30, 2016	**$ 118,940**	**$ 1,467**	**$ 27,780**	**$ 52,799**	**$ 206**	**$ 201,192**

As at June 30, 2016, the cost of the Company's property, plant and equipment includes $16,492 of prepayments to vendors (December 31, 2015: $16,492). 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.

As at June 30, 2016, certain of the Company's property, plant and equipment of $4,552 (December 31, 2015: nil) were pledged to secure a bank loan granted to the Company (Note 13).

11. INVESTMENT IN A JOINT VENTURE

The Company's investment consists of the following amounts:

	As at June 30, 2016	**As at December 31, 2015**
Non-current investment in joint venture		
Investment in RDCC LLC	**$ 25,884**	$ 25,667
Total investments	**$ 25,884**	$ 25,667

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 for the exclusive use of third party coal transport companies. In October 2012, the concession agreement was structured as a 17-year build, operate and transfer agreement. The construction was completed in 2014 and operations commenced in the second quarter of 2015. On September 17, 2015, the Invest Mongolia Agency signed an amendment to the concession agreement with RDCC LLC to extend the exclusive right of ownership to 30 years.

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

11. INVESTMENT IN A JOINT VENTURE (CONTINUED)

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

	Three months ended June 30,		Six months ended June 30,	
	2016	**2015**	**2016**	**2015**
Balance, beginning of period	**$ 24,973**	$ 26,689	**$ 25,667**	$ 26,574
Funds advanced	**-**	-	**-**	133
Dividend received	**(224)**	-	**(489)**	-
Share of earnings of a joint venture	**256**	151	**339**	133
Share of other comprehensive income of a joint venture	**879**	-	**367**	-
Balance, end of period	**$ 25,884**	$ 26,840	**$ 25,884**	$ 26,840

For the three and six months ended June 30, 2016, RDCC LLC recognized toll fee revenue of $1,361 and $2,195, respectively (For the three and six months ended June 30, 2015: $467). For the three and six months ended June 30, 2016, RDCC LLC had a net income of $641 and $848, respectively (For the three and six months ended June 30, 2015: $378 and $333, respectively).

12. TRADE AND OTHER PAYABLES

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

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

	As at	
	June 30, 2016	**December 31, 2015**
Less than 1 month	**$ 11,123**	$ 9,465
1 to 3 months	**2,787**	3,282
3 to 6 months	**4,858**	6,075
Over 6 months	**20,214**	12,095
Total trade and other payables	**$ 38,982**	$ 30,917

13. INTEREST-BEARING BORROWINGS

The Company's interest-bearing borrowings consist of the following amounts:

	As at	
	June 30, 2016	**December 31, 2015**
Turquoise Hill Loan Facility (i)	**$ 3,910**	$ 3,954
Short-term bridge loan (ii)	**6,176**	4,951
Bank loan (iii)	**2,026**	-
Total interest-bearing borrowings	**$ 12,112**	$ 8,905

13. INTEREST-BEARING BORROWINGS (CONTINUED)

(i) Turquoise Hill Loan Facility

On May 25, 2014, the Company announced it had obtained a loan from Turquoise Hill in the form of a $10,000 revolving credit facility to meet its short term working capital requirements (the "TRQ Loan"). The key commercial terms of the facility were: an original maturity date of August 30, 2014 (subsequently extended); an interest rate of one month US dollar LIBOR Rate in effect plus 11% per annum; a commitment fee of 35% of interest rate payable quarterly in arrears on undrawn principal amount of facility and a front end fee of $100.

During 2014 and 2015, the due date of the TRQ Loan, was extended several times and the credit limit has been reduced to $3,800.

On May 16, 2016, the Company and Turquoise Hill entered into the May 2016 Deferral Agreement, whereby Turquoise Hill agreed to a limited and circumscribed deferral of repayment of all remaining amounts and obligations now and hereafter owing under the TRQ Loan to December 29, 2017 in accordance with the schedule of repayment set out below:

- The Company has agreed to effect monthly repayments on the last business day of each month in an amount of (i) $150 per month starting on May 31, 2016 and ending on April 28, 2017 ($150 has been paid on July 31, 2016), (ii) $200 per month starting on May 31, 2017 and ending on December 29, 2017, and (iii) the remaining balance on December 29, 2017 (collectively (i) to (iii), the Repayments, and each, a Repayment). Upon receipt of each Repayment by Turquoise Hill, the aggregate amount of obligations owing under the TRQ Loan will be reduced by such equal amount;
- In the event that the Company fails to make any one of the Repayments in its entirety on or before the dates set out above, then the Company shall be in automatic and irremediable default of the obligations thereunder and under the TRQ Loan, shall immediately and irremediably lose all benefits of the May 2016 Deferral Agreement, and all then outstanding obligations shall become immediately due and payable to Turquoise Hill; and
- Interest shall continue to accrue on all outstanding obligations at 12-month US dollar LIBOR rate.

Under certain conditions, including the non-payment of interest amounts as the same become due, amounts outstanding under the TRQ Loan 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 TRQ Loan. Subject to notice and cure periods, certain events of default under the TRQ Loan will result in acceleration of the indebtedness under such loan at the option of Turquoise Hill.

At June 30, 2016, the outstanding principal and accrued interest under this facility amounted to $3,250 and $660, respectively (at December 31, 2015, the outstanding principal and accrued interest under this facility amounted to $3,400 and $554, respectively).

(ii) Short-term Bridge Loan

On October 27, 2015, the Company executed a $10,000 bridge loan agreement with an independent Asian based private equity fund.

The Company repaid the first tranche of the short-term bridge loan of $4,512 on July 26, 2016. During June and July 2016, the Company drew the second tranche of $5,038, $1,504 and $3,534 will mature in March and April 2017, respectively.

13. INTEREST-BEARING BORROWINGS (CONTINUED)

As at June 30, 2016, the outstanding balance for the short-term bridge loan was $6,016 (December 31, 2015: $4,885) and the Company owed accrued interest of $160 (December 31, 2015: $66).

(iii) Bank Loan

On May 6, 2016, the Company entered into a $2,000 loan agreement with a Mongolian bank. The key commercial terms of the loan are as follows:

- Maturity date of May 6, 2017;
- Interest rate of 15.8% per annum and payable monthly; and
- Certain items of property, plant and equipment in the amount of $4,552 were pledged.

As at June 30, 2016, the outstanding balance for the bank loan was $2,000 (December 31, 2015: nil) and the Company owed accrued interest of $26 (December 31, 2015: nil).

14. CONVERTIBLE DEBENTURE

14.1 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. 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 June 30, 2016.

14.2 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 CAD$ and U.S. Dollar) and spot foreign exchange rates.

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

14. CONVERTIBLE DEBENTURE (CONTINUED)

14.3 Valuation assumptions

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

	As at June 30, 2016	As at December 31, 2015
Floor conversion price	**CAD$8.88**	CAD$8.88
Ceiling conversion price	**CAD$11.88**	CAD$11.88
Common share price	**CAD$0.25**	CAD$0.39
Historical volatility	**76%**	74%
Risk free rate of return	**1.63%**	2.03%
Foreign exchange spot rate (CAD$ to U.S. Dollar)	**0.77**	0.72
Forward foreign exchange rate curve (CAD$ to U.S. Dollar)	**0.77 - 0.78**	0.72 - 0.74

14.4 Presentation

Based on the Company's valuation as at June 30, 2016, the fair value of the embedded derivatives decreased by $322 and $293 compared to March 31, 2016 and December 31, 2015, respectively. The change in fair value was recorded as finance income for the three and six months ended June 30, 2016.

For the three months ended June 30, 2016, the Company recorded interest expense of $5,274 related to the convertible debenture as a finance cost (2015: $5,089). For the six months ended June 30, 2016, the Company recorded interest expense of $10,522 related to the convertible debenture as a finance cost (2015: $10,061). The interest expense consists of the interest at the contract rate and the accretion of the debt host component of the convertible debenture. To calculate the accretion expense, the Company uses the contract life of 30 years and an effective interest rate of 22.2%.

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

	Three months ended June 30, 2016	Three months ended June 30, 2015	Six months ended June 30, 2016	Six months ended June 30, 2015
Balance, beginning of period	**$ 110,936**	$ 101,703	**$ 108,659**	$ 95,187
Interest expense on convertible debenture	**5,274**	5,089	**10,522**	10,061
Increase/(decrease) in fair value of embedded derivatives	**(322)**	(265)	**(293)**	1,279
Interest paid	**(1,000)**	-	**(4,000)**	-
Balance, end of period	**$ 114,888**	$ 106,527	**$ 114,888**	$ 106,527

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

14. CONVERTIBLE DEBENTURE (CONTINUED)

The convertible debenture balance consists of the following amounts:

	As at	
	June 30, 2016	**December 31, 2015**
Current convertible debenture		
Interest payable	**$ 23,088**	$ 16,671
Debt host	**91,336**	-
Fair value of embedded derivatives	**464**	-
	114,888	16,671
Non-current convertible debenture		
Debt host	**-**	91,231
Fair value of embedded derivatives	**-**	757
	-	91,988
Total convertible debenture	**$ 114,888**	$ 108,659

14.5 Interest deferral and settlement

On July 13, 2016, the Company executed a deferral agreement with CIC which covers outstanding deferred cash interest obligations and associated costs of $18,835 as of July 13, 2016 and the next Issue Date Anniversary Cash Interest payment of $8,066 due on November 19, 2016. Pursuant to the deferral agreement, the Company has agreed to repay $1,277 to $1,390 monthly from July 19 to November 19, 2016 and repay $20,653 on December 19, 2016. As a consideration for the deferred payments, the Company will pay a deferral fee at a rate of 6.4% per annum on the deferred amount to CIC. The payment on July 19, 2016 of $1,277 was made.

Although CIC and the Company had finalized the terms of a deferral of CIC interest payments at the end of the second quarter, a formal written agreement had not been executed as at June 30, 2016. As a consequence, IAS 1 required the Company to classify the entire balance of the CIC Convertible Debenture as a current liability as at June 30, 2016, notwithstanding the fact that CIC had agreed to the terms of the deferral and had not indicated any intention to deliver notice of default or accelerate the maturity of the debenture. Following the execution of the deferral agreement on July 13, 2016, the CIC Convertible Debenture met the requirements of IAS 1. The Company anticipates that both the debt host and the fair value of the embedded derivative will be classified as a non-current liability going forward, unless a future event of default occurs under the terms of the CIC Convertible Debenture. The interest due in July 2016 has been paid as at August 15, 2016.

15. EQUITY

15.1 Share Capital

The Company has authorized an unlimited number of common and preferred shares with no par value. At June 30, 2016, the Company had 257,694 common shares outstanding (December 31, 2015: 257,683) and no preferred shares outstanding (December 31, 2015: nil).

The Company’s volume weighted average share price for the six months ended June 30, 2016 was CAD$0.27 (2015: CAD$0.75).

15. EQUITY (CONTINUED)

15.2 Accumulated deficit and dividends

At June 30, 2016, the Company has accumulated a deficit of $1,068,973 (December 31, 2015: $1,034,942). No dividend has been paid or declared by the Company since inception.

16. SHARE-BASED PAYMENTS

16.1 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 six months ended June 30, 2016, the Company did not grant any stock options to officers, employees, directors and other eligible persons. For the six months ended June 30, 2015, the Company granted 539 stock options to officers, employees, directors and other eligible persons at an exercise price of CAD$0.92 and an expiry date of April 1, 2020. The weighted average fair value of the options granted in the six months ended June 30, 2015 was estimated at $0.15 (CAD$0.16) per option at the grant date using the Black-Scholes option pricing model.

A share-based compensation expense of $147 for the options granted in the six months ended June 30, 2015 will be amortized over the vesting period, of which $23 was recognized in the six months ended June 30, 2015.

The total share-based compensation expenses for the three months ended June 30, 2016 was $8 (2015: share-based compensation expense of $54). Share-based compensation expense of $12 (2015: $44) has been allocated to administration expenses, share-based compensation recovery of $3 (2015: share-based compensation expense of $6) has been allocated to cost of sales and share-based compensation recovery of $1 (2015: share-based compensation expenses of $4) has been allocated to evaluation and exploration expenses.

The total share-based compensation recovery for the six months ended June 30, 2016 was $6 (2015: share-based compensation expenses of $186). Share-based compensation expenses of $5 (2015: $145) has been allocated to administration expenses, share-based compensation recovery $8 (2015: share-based compensation expenses of $34) has been allocated to cost of sales and share-based compensation recovery of $3 (2015: share-based compensation expenses of $7) has been allocated to evaluation and exploration expenses.

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

16. SHARE-BASED PAYMENTS (CONTINUED)

16.2 Outstanding stock options

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

	Six months ended June 30, 2016		Six months ended June 30, 2015	
	Number of options	Weighted average exercise price (CAD$)	Number of options	Weighted average exercise price (CAD$)
Balance, beginning of period	**2,399**	**$ 1.52**	**3,052**	**$ 3.63**
Options granted	**-**	**-**	**539**	**0.92**
Options exercised	**-**	**-**	**(12)**	**0.65**
Options forfeited	**(305)**	**0.85**	**(792)**	**0.72**
Options expired	**(133)**	**0.95**	**(455)**	**8.02**
Balance, end of period	**1,961**	**$ 1.55**	**2,332**	**$ 3.15**

The stock options outstanding and exercisable as at June 30, 2016 are as follows:

	Options Outstanding			Options Exercisable		
Exercise price (CAD$)	Options outstanding	Weighted average exercise price (CAD$)	Weighted average remaining contractual life (years)	Options outstanding and exercisable	Weighted average exercise price (CAD$)	Weighted average remaining contractual life (years)
0.29 to 0.65	**1,429**	**$ 0.46**	**3.67**	**802**	**$ 0.58**	**3.11**
0.92 to 1.92	**288**	**1.27**	**2.93**	**167**	**1.53**	**2.34**
6.16 to 9.43	**244**	**8.23**	**0.34**	**245**	**8.23**	**0.34**
	1,961	**$ 1.55**	**3.15**	**1,214**	**$ 2.25**	**2.45**

17. FAIR VALUE MEASUREMENTS

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.

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

17. FAIR VALUE MEASUREMENTS (CONTINUED)

	As at June 30, 2016			
Recurring measurements	**Level 1**	**Level 2**	**Level 3**	**Total**
Financial liabilities at fair value				
Convertible debenture - embedded derivatives	**$ -**	**$ 464**	**$ -**	**$ 464**
Total financial liabilities at fair value	**$ -**	**$ 464**	**$ -**	**$ 464**

	As at December 31, 2015			
Recurring measurements	**Level 1**	**Level 2**	**Level 3**	**Total**
Financial iabilities at fair value				
Convertible debenture - embedded derivatives	$ -	$ 757	$ -	$ 757
Total financial liabilities at fair value	$ -	$ 757	$ -	$ 757

There were no transfers between Level 1, 2 and 3 for the six months ended June 30, 2016.

18. RELATED PARTY TRANSACTIONS

During the six months ended June 30, 2015, the Company had related party transactions with the following companies related by way of directors or shareholders in common:

- Turquoise Hill – Turquoise Hill provided various administrative services to the Company on commercial terms.
- Rio Tinto – Rio Tinto controlled Turquoise Hill. The Company recovered administration and other costs incurred on behalf of Rio Tinto on a cost-recovery basis. Rio Tinto recovered from the Company the costs of salaries and benefits of employees assigned to work for the Company and recovered legal and professional fees from the Company in respect of the internal and tripartite committees.
- Turquoise Hill Resources Singapore Pte. Ltd. (“Turquoise Hill Singapore”) – Turquoise Hill Singapore is a private company 100% owned by Turquoise Hill. Turquoise Hill Singapore provided information technology and other related services to the Company on a cost-recovery basis.

During the year ended December 31, 2015 the ownership of Turquoise Hill and its ultimate parent, Rio Tinto, in the Company declined below 20% and Turquoise Hill ceased to have significant influence, as defined by IFRS, over the operations of the Company. Accordingly, commencing January 1, 2016 transactions between the Company and Turquoise Hill and Rio Tinto no longer meet the definition of a related party transaction.

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

18. RELATED PARTY TRANSACTIONS (CONTINUED)

18.1 Related party expenses

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

	Three months ended June 30, 2015
Corporate administration	$ 130
Salaries and benefits	204
Finance costs	107
Related party expenses	$ 441

	Six months ended June 30, 2015
Corporate administration	$ 211
Salaries and benefits	144
Finance costs	213
Related party expenses	$ 568

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

	Three months ended June 30, 2015
Turquoise Hill	$ 107
Rio Tinto	251
Turquoise Hill Singapore	83
Related party expenses	$ 441

	Six months ended June 30, 2015
Turquoise Hill	$ 212
Rio Tinto	192
Turquoise Hill Singapore	164
Related party expenses	$ 568

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

18. RELATED PARTY TRANSACTIONS (CONTINUED)

18.2 Related party liabilities

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

	As at December 31, 2015
Amounts payable to Rio Tinto	$ 8,044
Accounts payable to Turquoise Hill Singapore	567
Accounts payable to Turquoise Hill	3,968
Total liabilities due to related parties	$ 12,579

19. SUPPLEMENTAL CASH FLOW INFORMATION

19.1 Net change in non-cash working capital items

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

	Six months ended June 30, 2016	Six months ended June 30, 2015
Decrease in inventories	**$ 2,754**	$ 90
Increase in trade and other receivables	**(4,787)**	(3,126)
Decrease/(increase) in prepaid expenses and deposits	**(2,736)**	241
Increase in trade and other payables	**7,781**	5,145
Increase/(decrease) in provision for court case penalty	**(1,524)**	18,049
Increase/(decrease) in deferred revenue	**1,626**	(392)
Net change in non-cash working capital items	**$ 3,114**	$ 20,007

20. COMMITMENTS FOR EXPENDITURE

As at June 30, 2016, the Company's commitments for expenditure that have not been disclosed elsewhere in the consolidated financial statements are as follows:

	Within 1 year	2-3 years	Over 3 years	Total
As at June 30, 2016				
Capital expenditure commitments	**$ 4**	**$ -**	**$ -**	**$ 4**
Operating expenditure commitments	**4,178**	**1,086**	**481**	**5,745**
Commitments	**$ 4,182**	**$ 1,086**	**$ 481**	**$ 5,749**
As at December 31, 2015				
Capital expenditure commitments	$ 7,328	$ 7,308	$ -	$ 14,636
Operating expenditure commitments	8,530	1,287	645	10,462
Commitments	$ 15,858	$ 8,595	$ 645	$ 25,098

The commitments for expenditure has decreased by $19,349 compared to December 31, 2015, principally as a result of the cancellation of spare parts purchase contracts.

21. CONTINGENCIES

21.1 Governmental and regulatory investigations

In 2014, the Company was subject to several investigations by Mongolia's Independent Authority Against Corruption (the "IAAC"). See "REGULATORY ISSUES AND CONTINGENCIES – Governmental and Regulatory Investigations" in the Company's Management Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") for the year ended December 31, 2015 available on SEDAR at www.sedar.com for further details.

In February 2015, the Mongolian Second District Criminal Court delivered a written verdict to the Company in respect of allegations of tax evasion by former employees of the Company (the "Tax Verdict"). The Tax Verdict pronounced the three former employees guilty and declared the Company's subsidiary, SouthGobi Sands LLC ("SGS"), to be financially liable as a "civil defendant" for a penalty (the "Tax Penalty") of MNT35.3 billion (approximately $18,200 on February 1, 2015). Following the refusal of the Supreme Court of Mongolia to hear the case on appeal in June 2015, the Tax Verdict has entered into force. The Tax Verdict is, however, not immediately payable and enforceable against SGS absent further actions prescribed by the laws of Mongolia. However, the Company made a corresponding provision for the court case penalty of $18.0 million in the second quarter of 2015 ($15,200 as at June 30, 2016) given the Tax Verdict has entered into force.

On October 6, 2015, the Company was informed by its Mongolian banks (where the Restricted Funds were held) that they had received an official request from the Court Decision Implementing Agency of Mongolia ("CDIA") to transfer the Restricted Funds according to the court decision. $1,200 was transferred to CDIA from the frozen bank accounts in October and November 2015.

During the second quarter of 2016, $1,523 has been paid as a partial settlement of the Tax Penalty. The Company intends to make additional payments of $1,200 and $3,800 in 2016 and 2017, respectively.

The Company is currently seeking to resolve amicably the dispute giving rise to the Tax Verdict in a manner that is both appropriate having regard to the Company's limited financial resources and supportive of a positive environment for foreign investment in Mongolia. While negotiations with the Government of Mongolia have proceeded well to date, a final and binding resolution has not yet been reached, and further negotiations may be required in light of the change of government as a result of the Mongolian elections in June 2016. The Company continues to believe that an amicable solution can be reached. There can be no assurance, however, that any such resolution can ultimately be successfully negotiated by the Company either at all or on favourable terms, or that the terms of any resolution to which the Government would ultimately be prepared to agree would not be materially adverse to the Company. In such case, this may result in an event of default under each of the CIC Convertible Debenture and the TRQ Loan and CIC and Turquoise Hill would each have the right to declare the full principal and accrued interest owing to such party immediately due and payable. Such an event of default under the CIC Convertible Debenture, the TRQ Loan, or the Company's inability to pay the Tax Penalty could result in voluntary or involuntary proceedings involving the Company (including bankruptcy). For further information see the Risk Factor entitled "If the Tax Verdict is enforceable against SGS and the Tax Penalty is immediately payable the Company will likely not have sufficient cash resources to satisfy the penalty imposed thereunder" in the Company's MD&A for the year ended December 31, 2015 available on SEDAR at www.sedar.com.

The Company has provided $15,219 for the court case penalty at June 30, 2016. The decrease from $18,049 as at June 30, 2015 is as a result of subsequent transfers from frozen bank accounts of $1,200, additional cash payments by the Company of $1,523 and foreign exchange adjustments.

21. CONTINGENCIES (CONTINUED)

21.2 Internal investigations

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 allegations raised in the context of investigations by Mongolian authorities. The former Chair of the Audit Committee also 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. The tripartite committee substantially completed the investigative stage 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 investigation 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, the outcome of which is unclear at this time but could have a material adverse effect on the Company.

In the opinion of management of the Company, at June 30, 2016 a provision for this matter is not required.

21.3 Mongolian IAAC investigation

In the first quarter of 2013, the Company was subject to orders imposed by the IAAC which placed restrictions on certain of the Company’s Mongolian assets. The orders were imposed on the Company in connection with the IAAC’s investigations of the Company as described above under "Governmental and Regulatory Investigations" and continued to be enforced by the Mongolian State Investigation Office. The restrictions on the assets were reaffirmed in the Tax Verdict and form part of the Tax Penalty payable by the Company (Note 21.1).

The orders related 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 restricted the use of in-country funds but did not have any material impact on the Company’s activities. The Restricted Funds were transferred to CDIA as partial payment of the Tax Verdict in October and November 2015.

Following a review by the Company and its advisers, it is the Company's view that the orders placing restrictions on certain of the Company’s Mongolian assets did not result in an event of default as defined under the terms of the CIC Convertible Debenture. However, the enforcement of the orders could ultimately result in an event of default of the Company’s CIC Convertible Debenture, which if it remains uncured for ten business days, would result in the principal amount owing and all accrued and unpaid interest will become immediately due and payable upon notice to the Company by CIC.

21. CONTINGENCIES (CONTINUED)

21.4 Class action lawsuit

In January, 2014, Siskinds LLP, a Canadian law firm, filed a class action against the Company, certain of its former senior officers and current directors, and its former auditors, Deloitte LLP, (the "Class Action") 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.

To commence and proceed with the Class Action, the plaintiff was required to bring the preliminary leave motion and to certify the Class Action as a class proceeding (the "Certification Motion"). The Court rendered its decision on the leave motion on November 5, 2015.

The Ontario Court dismissed the plaintiff's leave motion as against each of the former senior officers and former and current directors of the Company named in the Class Action on the basis that the "large volume of compelling evidence" proved the defense of reasonable investigation on the balance of probabilities and provided the basis for dismissing the Leave Motion as against them.

On May 24, 2016, the Ontario Superior Court of Justice granted the Company leave to appeal the decision made on November 5, 2015, which granted the plaintiff permission to commence an action claiming damages under the Ontario Securities Act with respect to the Company's restatement of financial statements as previously disclosed in the Company's public filings.

The plaintiff has also appealed. The Ontario Court of Appeal granted an adjournment of the plaintiff's original hearing date of June 27, 2016, pending the expected consolidation of the Divisional Court appeal brought on behalf of the Company. The parties have consented to a consolidation of the appeals in principle and are negotiating the terms of the Consent Order. It is expected that the Motion seeking consolidation on consent will be filed with the Court in August and the Court of Appeal will deal with the consolidation quickly. Assuming that the Court of Appeal will grant the consent order, the appeals will be perfected in September and heard together in the spring of 2017.

The Company disputes and is vigorously defending 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 Class Action or determine the amount of any potential losses, if any. However, the Company has judged a provision for this matter at June 30, 2016 is not required.

21.5 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.

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. At each reporting date, the Company assesses 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.

21. CONTINGENCIES (CONTINUED)

21.6 Special Needs Territory in Umnugobi

On February 13, 2015, the whole of the Soumber mining license and a portion of SGS' exploration license No.9443X (the “License Areas”) were included into a special protected area (to be further referred as Special Needs Territory “SNT”) newly set up by the Umnugobi Aimag’s Civil Representatives Khural (the “CRKh”) to establish a strict regime on the protection of natural environment and prohibit mining activities in the territory of the SNT.

On July 8, 2015, SGS and the Chairman of the CRKh, in his capacity as the respondent’s representative, reached an agreement (the “Amicable Resolution Agreement”) to exclude the License Areas from the territory of the SNT in full, subject to confirmation of the Amicable Resolution Agreement by the session of the CRKh. The parties formally submitted the Amicable Resolution Agreement to the appointed judge of the Administrative Court for her approval and requested a dismissal of the case in accordance with the Law of Mongolia on Administrative Court Procedure. On July 10, 2015, the judge issued her order approving the Amicable Resolution Agreement and dismissing the case, while reaffirming the obligation of CRKh to take necessary actions at its next session to exclude the License Areas from the SNT and register the new map of the SNT with the relevant authorities. Mining activities at the Soumber property cannot proceed until the License Areas are removed from the SNT.

On June 29, 2016, the Mongolian Parliament and Aimag’s Civil Representatives Khural election was held. Thus the newly established CRKh will take necessary actions on SNT. The Company has not yet received any indication on the timing of the next session of the CRKh.

21.7 Commercial arbitration in Hong Kong

On June 24, 2015, First Concept served a notice of arbitration (the “Notice”) on SGS in respect of a coal supply agreement dated May 19, 2014 as amended on June 27, 2014 (the "Coal Supply Agreement") for a total consideration of $11,500. The arbitral proceedings (the “Arbitration”) are deemed to have commenced on June 24, 2015, as the date when the respondent received the Notice.

The Company firmly rejects the allegations of First Concept in the Notice as lacking any merit. On October 26, 2015, the Company received the Statement of Claim from First Concept and will vigorously defend itself in the Arbitration, including claiming the relevant fees and damages from First Concept. The trial dates of the Arbitration are scheduled to be held in the fourth quarter of 2016.

There can be no assurance, however, that the Company will prevail in the Arbitration. Should SGS be unsuccessful in the Arbitration, the Company may not be able to re-pay the sum of $11,500. In such case, this may result in an event of default under the CIC Convertible Debenture and CIC would have the right to declare the full principal and accrued interest owing thereunder immediately due and payable. Such an event of default under the CIC Convertible Debenture or the Company’s inability to re-pay the sum of $11,500 to First Concept could result in voluntary or involuntary proceedings involving the Company (including bankruptcy). See Risk Factors in the Company's MD&A for the year ended December 31, 2015 available on SEDAR at www.sedar.com.

21. CONTINGENCIES (CONTINUED)

21.8 Notice of claim by former Chief Executive Officer

On June 30, 2015, the Company was served with a Notice of Civil Claim filed by the Company's former President and Chief Executive Officer, Alexander Molyneux, in the British Columbia Supreme Court. The claim relates to alleged breaches of Mr. Molyneux's employment agreement by the Company. In addition to the Company, Turquoise Hill, the Company's largest shareholder at the time of Mr. Molyneux's employment, was also named in the claim.

Mr. Molyneux acted as the Company's President (from April 2009) and Chief Executive Officer (from October 2009) until September 2012, when the Company terminated his employment.

Mr. Molyneux is seeking damages in excess of $1,000 in his Notice of Claim. SouthGobi reserves its right to pursue all legal rights and remedies available to it in connection with the proceedings. The Company filed a response to Civil Claim and Counterclaim in September 2015. A trial date has not yet been set.

21.9 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.

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 June 30, 2016, management has assessed that recognition of a provision for uncertain tax position is not necessary.

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

ADDITIONAL STOCK EXCHANGE INFORMATION

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

A1. TAXATION ON PROFITS

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

For the six months ended June 30, 2016 the Company recorded current income tax expense of $258 (2015: $1) related to withholding tax and assessable profit derived from Mongolia at prevailing rates. For the six months ended June 30, 2016, the Company did not record any deferred income tax expenses (2015: nil).

A2. FINANCIAL INSTRUMENTS

Cash

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

	As at	
	June 30, 2016	December 31, 2015
Denominated in U.S. Dollars	**$ 93**	$ 21
Denominated in Chinese Renminbi	**2,158**	94
Denominated in Mongolian Tugriks	**660**	182
Denominated in Canadian Dollars	**44**	20
Denominated in Hong Kong Dollars	**30**	60
Cash	**$ 2,985**	$ 377

Exposure to fluctuations in foreign exchange rates

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

	As at	
	June 30, 2016	December 31, 2015
Increase/ decrease in foreign exchange rate against US Dollar		
+5%	**$ 141**	$ 14
–5%	**(141)**	(14)

A3. COMPLIANCE WITH THE CODE ON CORPORATE GOVERNANCE PRACTICES

The Company has, throughout the six months ended June 30, 2016, applied the principles and complied with the requirements of its corporate governance practices as defined by the Board of Directors and all applicable statutory, regulatory and stock exchange listings standards.

A4. COMPLIANCE WITH MODEL CODE

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

The Board of Directors confirms that all of the Directors of the Company have complied with the required policies in the Company's Corporate Disclosure, Confidentiality and Securities Trading policy throughout the six months ended June 30, 2016.

A5. PURCHASE, SALE OR REDEPMTION OF THE COMPANY'S SECURITIES

Neither the Company nor any of its subsidiaries purchased, sold or redeemed any listed securities of the Company during the six months ended June 30, 2016.

A6. SUBSTANTIAL SHAREHOLDERS

As at June 30, 2016, the persons or corporations (not being a Director or chief executive of the Company) who had an interest or short position in the shares and underlying shares of the Company as recorded in the register of interests in shares required to be kept by the Company were as follows:

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

A6. SUBSTANTIAL SHAREHOLDERS (CONTINUED)

Name	Nature of interest	Shares held	Approximate % of issued shares
Novel Sunrise (note a)	Beneficial	72,127,140	27.99%
Hope Rosy Limited (note a)	Interest of controlled corporation	72,127,140	27.99%
China Cinda (HK) Investments Management Company Limited (note a)	Interest of controlled corporation	72,127,140	27.99%
China Cinda (HK) Holdings Company Limited (note a)	Interest of controlled corporation	72,127,140	27.99%
China Cinda Asset Management Co., Ltd. (note a)	Interest of controlled corporation	72,127,140	27.99%
The Ministry of Finance of the People's Republic of China ("MOF") (note a)	Interest of controlled corporation	72,127,140	27.99%
Land Breeze II S.a.r.l. (note b)	Beneficial	49,875,030	19.35%
Fullbloom Investment Corporation (note b)	Interest of controlled corporation	49,875,030	19.35%
CIC (note b)	Interest of controlled corporation	49,875,030	19.35%
TRQ (note c)	Beneficial	36,080,118	14.00%
Rio Tinto plc (note c)	Interest of controlled corporation	36,080,118	14.00%
China Wish Limited	Beneficial	15,004,823	5.82%

Notes:

(a) Novel Sunrise is a wholly-owned subsidiary of Hope Rosy Limited, which is a wholly-owned subsidiary of China Cinda (HK) Investments Management Company Limited. China Cinda (HK) Investments Management Company Limited is a wholly-owned subsidiary of China Cinda (HK) Holdings Company Limited, which is wholly owned by China Cinda Asset Management Co. Ltd. China Cinda Asset Management Co., Ltd. Is a partially owned by MOF. Accordingly, Hope Roxy Limited is deemed to be interested in shares held by Novel Sunrise; and each of China Cinda (HK) Investments Management Company Limited, China Cinda (HK) Holdings Company Limited, China Cinda Asset Management Co., Ltd. and MOF.

(b) Land Breeze II S.a.r.l. is a wholly-owned subsidiary of Fullbloom Investment Corporation, which is wholly owned by CIC. Accordingly, Fullbloom Investment Corporation and CIC are deemed to be interested in shares held by Land Breeze II S.a.r.l. and CIC.

(c) TRQ is partially owned by Rio Tinto plc, Accordingly, Rio Tinto plc is deemed to be interested in shares held by TRQ.

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 June 30, 2016.

A7. DIRECTORS' INTERESTS IN SHARES AND SHARE OPTIONS

As at June 30, 2016, the interests of the Company's directors in the shares and share options of the Company and its associated corporations are presented in the following tables.

A7. DIRECTORS' INTERESTS IN SHARES AND SHARE OPTIONS (CONTINUED)

Shares [(i)]

Name	Name of company	Nature of interest	Shares held	Percentage interest in the company
Current Directors				
Aminbuhe	SouthGobi Resources Ltd. ("SGQ") [(ii)]	N/A	Nil	Nil
	Novel Sunrise	N/A	Nil	Nil
	CIC	N/A	Nil	Nil
	TRQ	N/A	Nil	Nil
	Rio Tinto plc and its group companies (collectively "Rio Tinto Group")	N/A	Nil	Nil
Yulan Guo	SGQ [(1)]	N/A	Nil	Nil
	Novel Sunrise	N/A	Nil	Nil
	CIC	N/A	Nil	Nil
	TRQ	N/A	Nil	Nil
	Rio Tinto Group	N/A	Nil	Nil
Ningqiao Li	SGQ [(1)]	N/A	Nil	Nil
	Novel Sunrise	N/A	Nil	Nil
	CIC	N/A	Nil	Nil
	TRQ	N/A	Nil	Nil
	Rio Tinto Group	N/A	Nil	Nil
Zhu Liu	SGQ	N/A	Nil	Nil
	Novel Sunrise	N/A	Nil	Nil
	CIC	N/A	Nil	Nil
	TRQ	N/A	Nil	Nil
	Rio Tinto Group	N/A	Nil	Nil
Jin Lan Quan	SGQ	N/A	Nil	Nil
	Novel Sunrise	N/A	Nil	Nil
	CIC	N/A	Nil	Nil
	TRQ	N/A	Nil	Nil
	Rio Tinto Group	N/A	Nil	Nil
Mao Sun	SGQ	N/A	Nil	Nil
	Novel Sunrise	N/A	Nil	Nil
	CIC	N/A	Nil	Nil
	TRQ	N/A	Nil	Nil
	Rio Tinto Group	N/A	Nil	Nil
Huiyi Wang	SGQ	N/A	Nil	Nil
	Novel Sunrise	N/A	Nil	Nil
	CIC	N/A	Nil	Nil
	TRQ	N/A	Nil	Nil
	Rio Tinto Group	N/A	Nil	Nil

A7. DIRECTORS' INTERESTS IN SHARES AND SHARE OPTIONS (CONTINUED)

Name	Name of company	Nature of interest	Shares held	Percentage interest in the company
Former Director				
Pierre Lebel	SGQ	Direct	5,100	0.00%
	Novel Sunrise	N/A	Nil	Nil
	CIC	N/A	Nil	Nil
	TRQ	N/A	Nil	Nil
	Rio Tinto Group	N/A	Nil	Nil

(i) Amounts are presented in total shares held and are not in thousands of shares.
(ii) Messrs. Aminbuhe, Guo and Li are the principals of Voyage Wisdom Limited, a company which has the option to purchase 25,768,162 common shares of SGQ currently owned by Novel Sunrise.

A7. DIRECTORS' INTERESTS IN SHARES AND SHARE OPTIONS (CONTINUED)

Options [(i)]

Name	Name of company	Number of options held
Current Directors		
Aminbuhe	SGQ	100,000
	Novel Sunrise	Nil
	CIC	Nil
	TRQ	Nil
	Rio Tinto Group	Nil
Yulan Guo	SGQ	100,000
	Novel Sunrise	Nil
	CIC	Nil
	TRQ	Nil
	Rio Tinto Group	Nil
Zhu Liu	SGQ	100,000
	Novel Sunrise	Nil
	CIC	Nil
	TRQ	Nil
	Rio Tinto Group	Nil
Ningqiao Li	SGQ	100,000
	Novel Sunrise	Nil
	CIC	Nil
	TRQ	Nil
	Rio Tinto Group	Nil
Jin Lan Quan	SGQ	100,000
	Novel Sunrise	Nil
	CIC	Nil
	TRQ	Nil
	Rio Tinto Group	Nil
Mao Sun	SGQ	100,000
	Novel Sunrise	Nil
	CIC	Nil
	TRQ	Nil
	Rio Tinto Group	Nil
Huiyi Wang	SGQ	Nil
	Novel Sunrise	Nil
	CIC	Nil
	TRQ	Nil
	Rio Tinto Group	Nil

A7. DIRECTORS' INTERESTS IN SHARES AND SHARE OPTIONS (CONTINUED)

Name	Name of company	Number of options held
Former Director		
Pierre Lebel	SGQ	337,352
	Novel Sunrise	Nil
	CIC	Nil
	TRQ	Nil
	Rio Tinto Group	Nil

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

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

A8. SHARE OPTION PLAN

The particulars of the Company's share option plan are set out in Note 16 of the condensed consolidated interim financial statements. The following table discuss movements in the Company's share options during the six month ended June 30, 2016.

	Number of share options								
Name	At January 1, 2016	Granted during the period	Exercised during the period	Forfeited during the period	Expired during the period	At June 30, 2016	Date of grant of share options	Exercise period of share options	Exercise price (CAD$ per share)
Directors									
Ningqiao Li	100,000	-	-	-	-	100,000	December 14, 2015	December 14, 2016 - December 14, 2020	0.29
Aminbuhe	100,000	-	-	-	-	100,000	December 14, 2015	December 14, 2016 - December 14, 2020	0.29
Yulan Guo	100,000	-	-	-	-	100,000	December 14, 2015	December 14, 2016 - December 14, 2020	0.29
Zhu Liu	100,000	-	-	-	-	100,000	December 14, 2015	December 14, 2016 - December 14, 2020	0.29
Mao Sun	100,000	-	-	-	-	100,000	December 14, 2015	December 14, 2016 - December 14, 2020	0.29
Jin Lan Quan	100,000	-	-	-	-	100,000	December 14, 2015	December 14, 2016 - December 14, 2020	0.29
Former Directors									
Pierre Label	40,000	-	-	-	-	40,000	August 15, 2011	August 15, 2012 - August 15, 2016	9.43
	20,000	-	-	-	-	20,000	March 21, 2012	March 21, 2013 - March 21, 2017	6.16
	20,000	-	-	-	-	20,000	December 6, 2012	December 6, 2013 - December 6, 2017	1.92
	257,352	-	-	-	-	257,352	August 13, 2014	August 13, 2015 - August 15, 2019	0.58
Andre Deepwell	35,000	-	-	-	-	35,000	August 15, 2011	August 15, 2012 - August 15, 2016	9.43
	20,000	-	-	-	-	20,000	March 21, 2012	March 21, 2013 - March 21, 2017	6.16
	20,000	-	-	-	-	20,000	December 6, 2012	December 6, 2013 - December 6, 2017	1.92
	257,352	-	-	-	-	257,352	August 13, 2014	August 13, 2015 - August 15, 2019	0.58
Gordan Lancaster	35,000	-	-	-	-	35,000	August 15, 2011	August 15, 2012 - August 15, 2016	9.43
	17,500	-	-	-	-	17,500	March 21, 2012	March 21, 2013 - March 21, 2017	6.16
	17,500	-	-	-	-	17,500	December 6, 2012	December 6, 2013 - December 6, 2017	1.92
	257,352	-	-	-	-	257,352	August 13, 2014	August 13, 2015 - August 15, 2019	0.58
Enkh-Amgalan Sengee	70,000	-	-	(23,800)	(46,200)	-	August 14, 2013	August 14, 2014 - March 13, 2016	1.16
	123,554	-	-	(82,781)	(40,773)	-	August 13, 2014	August 13, 2015 - March 13, 2016	0.58
Total for directors	**1,790,610**	**-**	**-**	**(106,581)**	**(86,973)**	**1,597,056**			
Other share option holders	45,000	-	-	-	-	45,000	August 15, 2011	August 15, 2012 - August 15, 2016	9.43
	32,000	-	-	-	-	32,000	March 21, 2012	March 21, 2013 - March 21, 2017	6.16
	54,500	-	-	-	(10,000)	44,500	December 6, 2012	December 6, 2013 - December 6, 2017	1.92
	32,847	-	-	-	-	32,847	March 26, 2014	March 26, 2015 - March 26, 2019	0.65
	32,618	-	-	-	(8,484)	24,134	August 13, 2014	August 13, 2015 - March 13, 2016	0.58
	411,020	-	-	(198,206)	(27,140)	185,674	April 1, 2015	April 1, 2016 - April 1, 2020	0.92
Total for other share option holders	**607,985**	**-**	**-**	**(198,206)**	**(45,624)**	**364,155**			
Total	**2,398,595**	**-**	**-**	**(304,787)**	**(132,597)**	**1,961,211**			