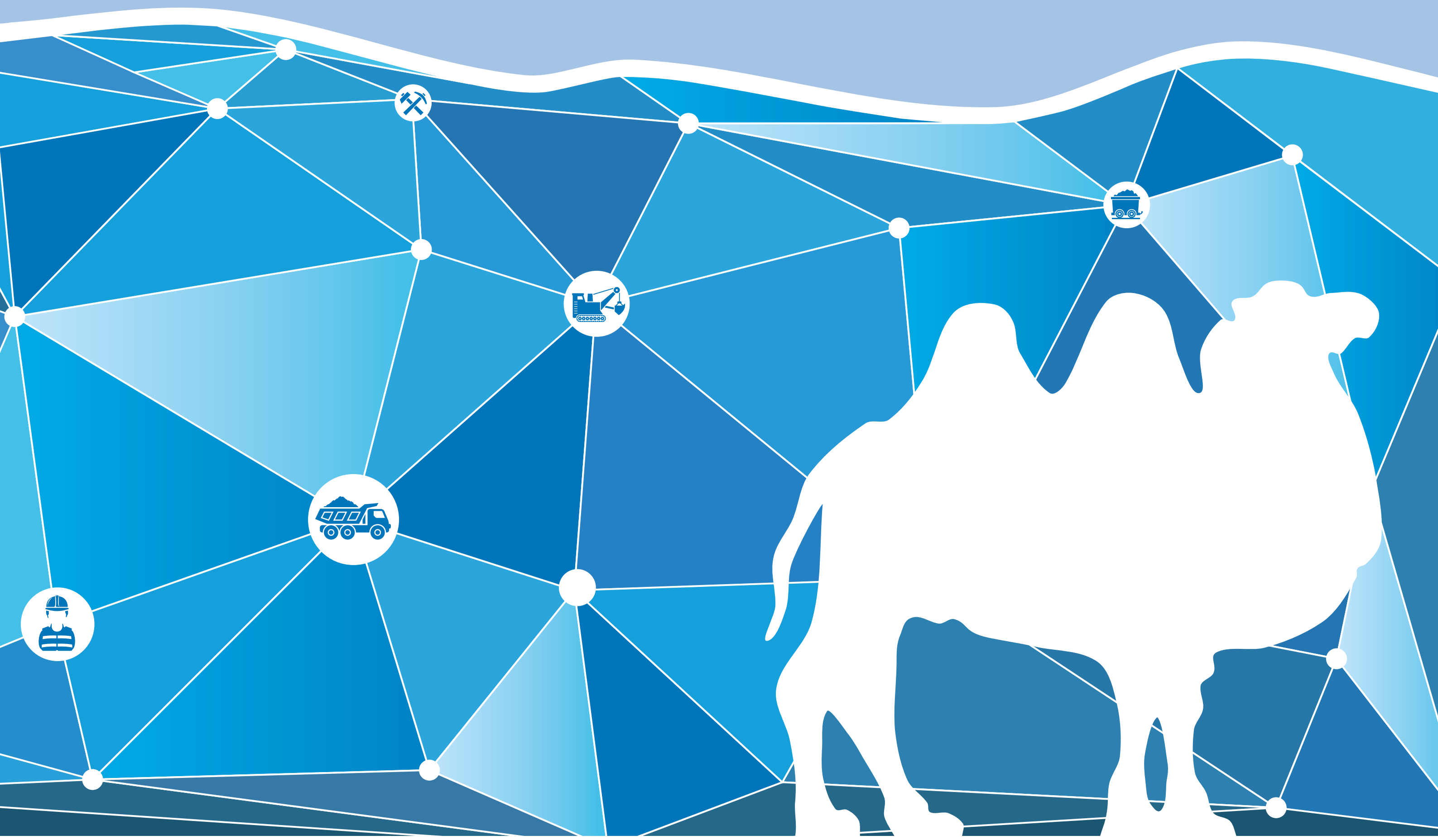
SouthGobi
RESOURCES

TSX: SGQ HKEX: 1878



ANNUAL REPORT 2017

www.southgobi.com

SouthGobi Resources Ltd.
Annual Report 2017

CONTENTS

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

English text of this Annual Report shall prevail over the Chinese text in case of inconsistencies.

MESSAGE FROM THE INTERIM CEO

SouthGobi achieved numerous accomplishments, as well as improved financial results, in 2017. The Company has doubled its revenues as compared to the prior year, generated a five-year record gross profit and narrowed its net loss, which are all as a result of improved coal sales, higher coal production, increased average selling price of coal and enhanced cash flow management during 2017.

All of these achievements are as a result of the valued contributions from each of SouthGobi's employees over the year and, on behalf of the Board and the Management team, I would like to thank every staff member for their dedicated effort.

To begin with the safety indicator, the Company experienced a lost time injury frequency rate of 0.03 per 200,000 man hours based on a rolling 12 month average as at December 31, 2017. Safety continues to be our top priority, and we remain committed to ensuring we continue to operate in a safe and socially responsible manner.

The Chinese coal market has stabilized in 2017 with improved market conditions and coal prices. This improvement was as a result of China implementing supply side reform policies in 2016 to resolve and control overcapacity issues. SouthGobi was able to benefit from these measures which are reflected in our operational and financial results. Throughout 2017, SouthGobi continued to improve operation efficiency and productivity while enhancing the product mix and product quality. We also managed our working capital diligently by obtaining more deposits from customers and utilizing trade financing in order to speed up the collection cycle.

The tax investigation dispute in Mongolia was fully resolved in January 2018 and the related enforcement procedure has been terminated. SouthGobi will continue to work closely with Mongolian authorities to ensure compliance with all applicable Mongolian rules and regulations.

SouthGobi is working to improve the coal product mix by processing certain grades of coal through coal washing to produce higher-quality coal and improve the selling prices and margins. The construction of the wash plant at Ovoot Tolgoi was substantially completed in 2017, and SouthGobi is expecting to commission and start the commercial operation of the wash plant in 2018.

Meanwhile, SouthGobi launched the Ceke Logistics Park project in 2017 to facilitate compliance with the Chinese government's policy to combat pollution in the Ceke Port and strengthen the supervision of coal storage and transport. Development of the Ceke Logistics Park will also represent a strategic transformation for the Company, evolving from a mining company into an integrated coal supplier and extending its downstream supply chain to reach end-customers.

SouthGobi foresees that market conditions and coal prices will continue to stabilize in 2018 and remains cautiously optimistic, as Mongolian coal exports remain highly correlated with the Chinese economy and any governmental policies implemented. China has continued to execute its "One Belt, One Road" program during the year. The Company believes that it is well positioned to capture the business opportunities between China and Mongolia resulting from this program.

In 2018, SouthGobi aims to increase its coal sales, enhance the product mix by utilizing the coal washing plant, optimize the cost structure and continue to expand the sales network.

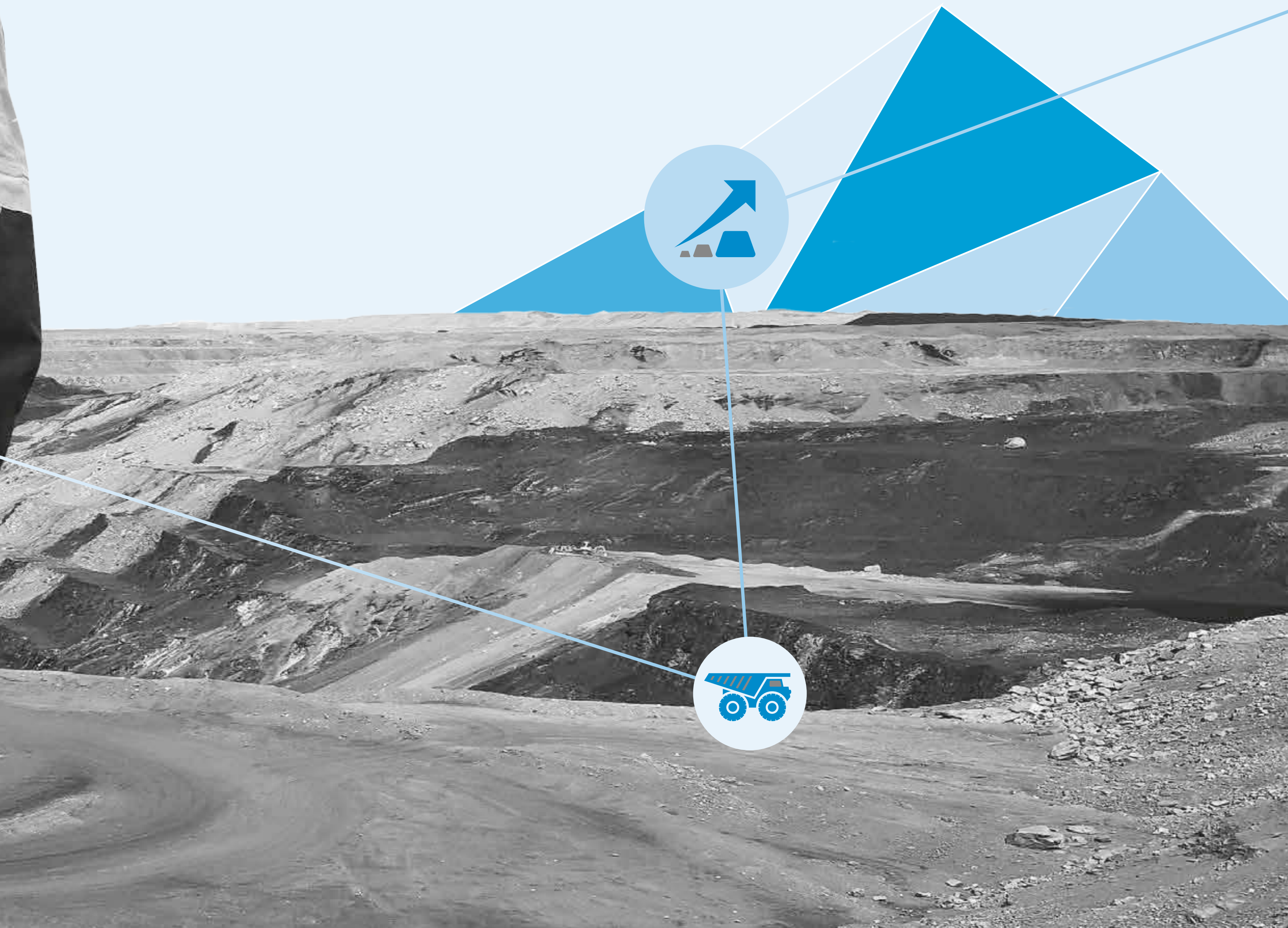
On behalf of the Management team, I would like to thank all SouthGobi staff, the communities and authorities of Mongolia and China, our customers, suppliers and shareholders for all the support throughout the years.

Bing Wang
Interim Chief Executive Officer


SouthGobi Sands

BRIDGE BETWEEN MONGOLIA AND CHINA

The Company is well positioned to capture the resulting business opportunities between the two countries given the potential strategic support from its largest shareholders (CIC and Cinda), which are both state-owned-enterprises in China; and its strong operational record for the past ten years in Mongolia, being one of the largest enterprises in the country.



BOARD OF DIRECTORS AND SENIOR MANAGEMENT

Yulan Guo

Executive Director and Chief Financial Officer

Mr. Guo, 33, joined the Company as a Non-Executive Director on May 15, 2015 and became an Executive Director on July 26, 2015, upon his appointment to the position of Interim Chief Executive Officer at that time. Mr. Guo was appointed as the Company's Chief Financial Officer in September 2015.

Mr. Guo commenced his career in 2008 with China International Capital Corporation Limited, the leading investment bank in the greater China market where he most recently held the position of Vice President of the Investment Banking Department.

Mr. Guo has extensive transaction experience in capital markets in mainland China, Hong Kong and the United States of America. He has arranged significant equity and debt financings and has been involved in mergers and acquisitions. Mr. Guo has developed industry expertise in the financial and operational aspects of the metals and mining, power, and energy sectors. Previously, Mr. Guo was a Director of Novel Sunrise Investments Limited.

Mr. Guo graduated from Peking University where he obtained Master of Science and Bachelor of Science Degrees. He completed the Master of Business Administration program at the University of International Business and Economics in Beijing. Mr. Guo is a member of the Canadian Institute of Corporate Directors.

Mao Sun

Independent Non-Executive Director and Interim Lead Director

Mr. Sun, 41, joined the Board of Directors on November 5, 2015 as an Independent Non-Executive Director and was appointed as Interim Lead Director on August 16, 2016.

Mr. Sun is the founding partner of Mao & Ying LLP (formerly SunRonkai LLP), a private accounting firm offering tax, assurance and management consulting services.

Mr. Sun has over 15 years' experience in the accounting sector and has extensive knowledge of Canadian accounting standards, International Financial Reporting Standards and Canadian taxation laws. Mr. Sun has extensive experience with Canadian listed companies. Since 2014, Mr. Sun has been the Chief Financial Officer of HFX Holding Corp and, since 2017, an independent Director of China Minerals Mining Corporation. Mr. Sun was a Director and Chairman of the audit committee for Yalian Steel Corporation from 2012 to 2013. Prior to founding SunRonkai LLP, Mr. Sun was the audit manager in the Vancouver office of KPMG, an internationally recognized accounting firm.

Mr. Sun graduated from Columbia University in New York with a Master Degree in International Affairs, International Finance and Business, and a Bachelor Degree in Computer Science from Nanjing University, China. Mr. Sun is a member of the Institute of Chartered Accountants of British Columbia, the Canadian Tax Foundation and the Canadian Institute of Corporate Directors.

BOARD OF DIRECTORS AND SENIOR MANAGEMENT

Yingbin Ian He

Independent Non-Executive Director

Mr. He, 56, joined the Board of Directors on May 16, 2017 as an Independent Non-Executive Director.

Mr. He's career in the mining industry has spanned over 30 years, with extensive senior executive and board experience. Mr. He is an Independent Non-Executive Director of China Gold International Resources Corp. Ltd., a company dually listed on the Toronto and Hong Kong Stock Exchanges, a Director and President of Tri-River Ventures Inc., which is listed on the TSX Venture Exchange in Canada and a Director of Zhongrun Resources Investment Corporation, a resources investment company listed on Shenzhen Stock Exchange. Mr. He was previously a director of Huaxing Machinery Corp., which is listed on TSX Venture Exchange in Canada, from Janurary 2011 to January 2017. In his early career, Mr. He worked as a mineral process engineer and coal preparation engineer in Canadian mining companies and an engineering consulting company.

Mr. He obtained his Doctoral and Master's degrees in mineral process engineering from the University of British Columbia in Canada and his Bachelor Degree in coal preparation from Heilongjiang Institute of Mining and Technology (presently known as the Heilongjiang University of Technology) in China. Mr. He is a member of the Canadian Institute of Mining, Metallurgy and Petroleum and the Canadian Institute of Corporate Directors.

Zhu Liu

Independent Non-Executive Director

Mr. Liu, 72, joined the Board of Directors on August 6, 2015 as an Independent Non-Executive Director.

Mr. Liu has had a distinguished career in the shipping industry spanning over 40 years. As former Deputy Chief Executive Officer and President of China Ocean Shipping (Group) Company ("COSCO"), Mr. Liu gained extensive operation and management experience derived from overseeing the company's large multinational logistics enterprises. This position also provided him with unique transportation and logistics industry expertise. While at COSCO, Mr. Liu led the debt restructuring of Orient Overseas Hong Kong Corporation on behalf of COSCO.

Mr. Liu studied in France, initially at the Faculty of Arts of University of Paris from 1964 to 1967 and subsequently at the University of Grenoble. In 1987, Mr. Liu obtained the title of Senior Economist in China and in 1989 was a member of the China Strait Affairs Council. Mr. Liu is a member of the Canadian Institute of Corporate Directors.

BOARD OF DIRECTORS AND SENIOR MANAGEMENT

Jin Lan Quan

Independent Non-Executive Director

Ms. Quan, 55, joined the Board of Directors on August 6, 2015 as an Independent Non-Executive Director.

Ms. Quan is an independent financial planner and business consultant based in Sydney, Australia. Prior to her current role, Ms. Quan developed extensive and diverse finance and audit experience during her time as an audit partner with Arthur Anderson in Sydney, Australia. Ms. Quan has extensive experience in financial consulting services with specialist skills in external auditing, internal audit structuring, corporate financing and risk management and business acquisition.

Ms. Quan is a Certified Public Accountant of China and a member of the Chinese Institute of Certified Public Accountants. She is also a Fellow of the Association of Chartered Certified Accountants of United Kingdom and a member of the Canadian Institute of Corporate Directors.

Wen Yao

Non-Executive Director

Mr. Yao, 48, joined the Board of Directors on May 18, 2017 as a Non-Executive Director.

Mr. Yao is currently a Managing Director of CIC Capital Corporation ("CIC Capital"), a wholly owned subsidiary of China Investment Corporation ("CIC") and is responsible for CIC Capital's global investment in the metals and mining industry and management of its existing portfolio assets in the same sector. Prior to joining CIC Capital in 2015, Mr. Yao was a Managing Director of the Legal and Compliance Department at CIC. He has extensive experience and knowledge of legal matters relating to investments in public and private companies, post-investment management and compliance, risk management, corporate governance policies and various corporate matters. Prior to joining CIC in 2010, Mr. Yao was in private practice at leading international law firms in the United States of America and the United Kingdom, representing public and private companies in a variety of industries, mergers and acquisitions, private equity investments and financings, venture capital financings, strategic alliance and joint venture transactions, public and private offerings, and cross-border transactions.

Mr. Yao received his Master of Business Administration and Juris Doctor Degrees from Kellogg School of Management and Pritzker School of Law of Northwestern University in the United States of America, respectively. Mr. Yao is a member of the Canadian Institute of Corporate Directors.

BOARD OF DIRECTORS AND SENIOR MANAGEMENT

Aminbuhe

Non-Executive Director

Mr. Aminbuhe, 42, became an Executive Director of the Company in September 2015 and became a Non-Executive Director of the Company in November 2017.

Mr. Aminbuhe has extensive senior executive experience in the Mongolian and Chinese coal industry, including sales and marketing, logistics and operation management. Mr. Aminbuhe is a Director of the Canada Inner Mongolia Chamber of Commerce. Mr. Aminbuhe was the Company's Chief Executive Officer from September 2015 to November 2017. Prior to joining the Company, Mr. Aminbuhe was an Executive Director at National United Resources Holding Limited and was the Chairman of Inner Mongolia Ejina Jin Yun Kun Tai Industrial Development Co. Ltd.

Mr. Aminbuhe graduated from the Beijing Institute of Technology with a Bachelor Degree in Management Engineering and is a member of the Canadian Institute of Corporate Directors.

Bing Wang

Interim Chief Executive Officer

Mr. Wang, 44, was appointed as the Company's Interim Chief Executive Officer in November 2017. Prior to this appointment and commencing in December 2015, Mr. Wang was the Company's General Manager of Sales and Marketing. He was responsible for the oversight of the coal marketing and operations management of the Company. Mr. Wang is also the legal representative, Executive Director and general manager of two of the Company's subsidiaries, namely Inner Mongolia SouthGobi Enterprise Co. Ltd. and Chongqing SouthGobi Energy Ltd.

Prior to joining the Company, Mr. Wang was the sales director of Haier International Business Group and was responsible for its commodity trading business.

Mr. Wang graduated from Tianjin University Mechanics School in 1995. He is a member of the Canadian Institute of Corporate Directors.

STRATEGIC LOCATION

The Ovoot Tolgoi Mine is located approximately 40km from China, which represents the Company's 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.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DIRECTORS' REPORT

The board of directors (the "Directors" and the "Board", respectively) of SouthGobi Resources Ltd. ("SGQ") is pleased to present its report along with the audited consolidated financial statements (the "Financial Statements") of SGQ together with its subsidiaries (collectively the "Company") for the financial year ended December 31, 2017 (the "Financial Year").

Principal activities, business review and geographical analysis of operations

The Company is an integrated coal mining, development and trading company. The Company's significant subsidiaries are set out in Note 32 to the Financial Statements and the activities of all subsidiaries of the Company as at December 31, 2017 are set out in the table below:

Name	Country of incorporation	Issued ordinary/ registered share capital	Principal activities
SGQ Coal Investment Pte. Ltd.	Singapore	US$1	Investment holding
SGQ Dayarcoal Mongolia Pte. Ltd.	Singapore	US$1	Investment holding
Mazaatt Holdings Pte. Ltd.	Singapore	US$1	Investment holding
SouthGobi Sands LLC	Mongolia	MNT242,713,000	Coal mining, development and exploration of properties in Mongolia
Mazaalai Resources LLC	Mongolia	MNT1,000,000	Investment holding
Mazaatt Holdings LLC	Mongolia	MNT242,713,000	Investment holding
Dayarbulag LLC	Mongolia	MNT242,713,000	Investment holding
SouthGobi Resources (Hong Kong) Limited	Hong Kong	HK$1	Business services and investment holding
TST Holdings Limited	Hong Kong	HK$1	Investment holding
SouthGobi Trading (Beijing) Co., Ltd.	China	US$400,000	Investment holding
Inner Mongolia SouthGobi Energy Co., Ltd.	China	CNY100,000,000	Import agency and trading of coal
Chongqing SouthGobi Energy Ltd.	China	HK$10,000,000	Coal trading
Inner Mongolia SouthGobi Enterprise Co., Ltd	China	CNY100,000,000	Storage and warehouse service, customs clearance service and transportation for imported goods

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

A review of the business of the Company during the Financial Year and a further discussion and analysis of these activities, including a description of the principal risks and uncertainties the Company may be facing and an indication of likely future development in the Company's business, can be found in Management's Discussion and Analysis set out on pages 42 to 116 of this Annual Report. The discussion forms part of this directors' report.

Results

The results of the Company for the Financial Year are set out in the Consolidated Statement of Comprehensive Income on page 128 of this Annual Report.

Dividends

The Board does not recommend the payment of any final dividend for the Financial Year (2016: Nil). No interim dividend was declared or paid during the Financial Year (2016: Nil).

Property, plant and equipment

Details of the movements in the property, plant and equipment of the Company during the Financial Year are set out in Note 18 to the Financial Statements.

Share capital

Details of the movements in the share capital of the Company during the Financial Year are set out in Note 27 to the Financial Statements and in the Consolidated Statement of Changes in Equity on page 130 of this Annual Report.

The Company did not enter into any private placements for equity or debt securities during the Financial Year.

Purchase, sale or redemption of listed securities

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

Reserves

Details of the reserves available for distribution to the shareholders of the Company (the "Shareholders") as at December 31, 2017 are set out in the Consolidated Statement of Changes in Equity on page 130 of this Annual Report.

DIRECTORS' REPORT

Directors

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

Independent Non-Executive Directors (the "INEDs")

Current

Mr. Mao Sun *(Interim Independent Lead Director)*

Mr. Yingbin Ian He [(1)]

Mr. Zhu Liu

Ms. Jin Lan Quan

Prior Independent Non-Executive Director

Mr. Joseph Belan [(5)]

Prior Executive Director

Mr. Ningqiao Li [(6)(8)]

Prior Non-Executive Director

Mr. Huiyi Wang [(7)]

Executive Director

Current

Mr. Yulan Guo [(2)(8)]

Non-Executive Directors

Current

Mr. Wen Yao [(3)]

Mr. Aminbuhe [(4)(8)]

Notes:

1) Mr. He joined the Board as an INED on May 16, 2017;

2) Mr. Guo is an Executive Director and the Chief Financial Officer of the Company;

3) Mr. Yao joined the Board as a Non-Executive Director on May 18, 2017;

4) Mr. Aminbuhe was re-designated from an Executive Director to a Non-Executive Director on November 22, 2017. He was appointed as the Chairman of the Board (the "Chairman") on June 30, 2017 and ceased as the Chairman and the Chief Executive Officer of the Company ("CEO") on November 22, 2017;

5) Mr. Belan did not stand for re-election at the Annual General Meeting ("AGM") held on June 30, 2017 and ceased to be an INED on June 30, 2017. Mr. Belan has confirmed that he has no disagreement with the Board and that there are no matters which need to be brought to the attention of the Shareholders;

6) Mr. Li did not stand for re-election at the AGM and ceased to be an Executive Director and Executive Chairman on June 30, 2017. Mr. Li confirmed that he has no disagreement with the Board and that there are no matters which need to be brought to the attention of the Shareholders;

7) Mr. Wang resigned as a Non-executive Director on July 24, 2017. Mr. Wang has confirmed that he has no disagreement with the Board and that there are no matters which need to be brought to the attention of the Shareholders; and

8) Messrs. Guo, Aminbuhe and Li are directors and shareholders of Voyage Wisdom Limited, a private company which owned 9.45% of the Company's issued and outstanding common shares at December 31, 2017.

Except where such Director has already resigned from the Board, the term of office for each of the Directors will end at the conclusion of the forthcoming AGM (the "2018 AGM"). In accordance with article 14.1 of the articles of continuation of the Company (the "Articles of Continuation"), all of the Directors, including the INEDs and the Non-Executive Directors, would retire and, being eligible, may offer themselves for re-election at the 2018 AGM.

The Company has received written annual confirmations of independence from Messrs. He, Liu and Sun and Ms. Quan, all INEDS, and as at the date of this report considered them to be independent in accordance with the applicable listing rules.

Directors' service contracts

None of the Directors proposed for re-election at the 2018 AGM has a service contract with the Company, which is not determinable by the Company within one year without payment of compensation other than statutory compensation.

Directors' interests in transactions, arrangements or contracts of significance

No transactions, arrangements or contracts of significance in relation to the Company's business to which the Company or any of its subsidiaries was a party and in which a Director or a connected entity of a Director had a material interest, whether directly or indirectly, subsisted at the end of the Financial Year or at any time during the Financial Year.

Directors' interests in competing businesses

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

Directors' and chief executive's interests and short positions in shares, underlying shares and debentures

As at December 31, 2017, or in the case of a departed Director as at his resignation/retirement date, the interests of the Directors and chief executive of the Company in the shares, underlying shares and debentures of the Company and its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong)) were as follows:

DIRECTORS' REPORT

Interests in common shares of SGQ (the "Shares"):

Name of Directors	Number of Shares and underlying Shares held, capacity and nature of interest: Directly beneficially owned	Number of Shares interested: Through spouse or minor children	Number of Shares interested: Through controlled company	Beneficiary of a trust	Number of underlying Shares interested: Directly beneficially owned	Total [6]	Approximate percentage of SGQ's issued Shares [5]
Current Directors							
Aminbuhe	–	–	25,768,162 [1]	–	100,000 [4]	25,868,162	9.49%
Yulan Guo	–	–	25,768,162 [2]	–	100,000 [4]	25,868,162	9.49%
Yingbin Ian He	–	–	–	–	250,000 [4]	250,000	0.09%
Zhu Liu	–	–	–	–	400,000 [4]	400,000	0.15%
Jin Lan Quan	–	–	–	–	400,000 [4]	400,000	0.15%
Mao Sun	–	–	–	–	500,000 [4]	500,000	0.18%
Former Directors							
Joseph Belan	–	–	–	–	250,000 [4]	250,000	0.09%
Ningqiao Li	–	–	25,768,162 [3]	–	100,000 [4]	25,868,162	9.49%

Notes:

(1) Mr. Aminbuhe is a director of and owns 45% of Voyage Wisdom Limited, a private company which owned a 9.45% interest in the Company as at December 31, 2017.

(2) Mr. Guo is a director of and owns 10% of Voyage Wisdom Limited, a private company which owned a 9.45% interest in the Company as at December 31, 2017.

(3) Mr. Li is a director of and owns 45% of Voyage Wisdom Limited, a private company which owned a 9.45% interest in the Company as at December 31, 2017.

(4) These interests represented the underlying Shares comprised in the share options granted by the Company.

(5) The percentage represents the total number of the Shares and the underlying Shares interested divided by the number of issued Shares as at December 31, 2017 (i.e. 272,607,299 Shares).

(6) All interests stated above are long positions.

Other than the shareholdings disclosed in the preceding table, none of the Directors of the Company had any interests or short positions in any shares, underlying shares or debentures of the Company or any of its associated corporations as at December 31, 2017.

Share option plan

The particulars of the Company's share option plan (the "Share Option Plan") are set out in Note 28 to the Financial Statements. The following table discloses movements in the Company's share options for the Financial Year:

	Number of share options								
Name	At January 1, 2017	Granted during the year	Exercised during the year	Forfeited during the year	Expired during the year	At December 31, 2017	Date of grant*	Exercise period of share options	Exercise price of share options** CAD$ per share
Aminbuhe	100,000	–	–	–	–	100,000	December 14, 2015	December 14, 2016 – December 14, 2020	0.29
	100,000	**–**	**–**	**–**	**–**	**100,000**			
Yulan Guo	100,000	–	–	–	–	100,000	December 14, 2015	December 14, 2016 – December 14, 2020	0.29
	100,000	**–**	**–**	**–**	**–**	**100,000**			
Yingbin Ian He	–	100,000	–	–	–	100,000	June 5, 2017	June 5, 2018 – June 5, 2022	0.39
	–	150,000	–	–	–	150,000	June 30, 2017	June 30, 2018 – June 30, 2022	0.33
	–	**250,000**	**–**	**–**	**–**	**250,000**			
Zhu Liu	100,000	–	–	–	–	100,000	December 14, 2015	December 14, 2016 – December 14, 2020	0.29
	75,000	–	–	–	–	75,000	November 16, 2016	November 16, 2017 – November 16, 2021	0.33
	75,000	–	–	–	–	75,000	November 16, 2016	November 16, 2018 – November 16, 2021	0.33
	–	150,000	–	–	–	150,000	June 30, 2017	June 30, 2018 – June 30, 2022	0.33
	250,000	**150,000**	**–**	**–**	**–**	**400,000**			
Jin Lan Quan	100,000	–	–	–	–	100,000	December 14, 2015	December 14, 2016 – December 14, 2020	0.29
	75,000	–	–	–	–	75,000	November 16, 2016	November 16, 2017 – November 16, 2021	0.33
	75,000	–	–	–	–	75,000	November 16, 2016	November 16, 2018 – November 16, 2021	0.33
	–	150,000	–	–	–	150,000	June 30, 2017	June 30, 2018 – June 30, 2022	0.33
	250,000	**150,000**	**–**	**–**	**–**	**400,000**			
Mao Sun	100,000	–	–	–	–	100,000	December 14, 2015	December 14, 2016 – December 14, 2020	0.29
	100,000	–	–	–	–	100,000	November 16, 2016	November 16, 2017 – November 16, 2021	0.33
	100,000	–	–	–	–	100,000	November 16, 2016	November 16, 2018 – November 16, 2021	0.33
	–	200,000	–	–	–	200,000	June 30, 2017	June 30, 2018 – June 30, 2022	0.33
	300,000	**200,000**	**–**	**–**	**–**	**500,000**			
Wen Yao	n/a	n/a	n/a	n/a	n/a	n/a			
	–	**–**	**–**	**–**	**–**	**–**			
Joseph Belan	100,000	–	–	–	–	100,000	August 26, 2016	June 30, 2017 – June 30, 2018	0.25
	75,000	–	–	–	–	75,000	November 16, 2016	June 30, 2017 – June 30, 2018	0.33
	75,000	–	–	–	–	75,000	November 16, 2016	June 30, 2017 – June 30, 2018	0.33
	250,000	**–**	**–**	**–**	**–**	**250,000**			
Huiyi Wang	n/a	n/a	n/a	n/a	n/a	n/a			
	–	–	–	–	–	–			
Ningqiao Li	100,000	–	–	–	–	100,000	December 14, 2015	December 14, 2016 – June 30, 2018	0.29
	100,000	**–**	**–**	**–**	**–**	**100,000**			
Total for directors and former directors	**1,350,000**	**750,000**	**–**	**–**	**–**	**2,100,000**			
Other share option holders	52,000	–	–	–	(52,000)	–	March 21, 2012	March 21, 2013 – March 21, 2017	6.16
	54,500	–	–	–	(54,500)	–	December 6, 2012	December 6, 2013 – December 6, 2017	1.92
	8,885	–	–	–	–	8,885	March 26, 2014	March 26, 2015 – March 26, 2019	0.65
	281,486	–	–	–	(257,352)	24,134	August 13, 2014	August 13, 2015 – August 13, 2019	0.58
	163,056	–	–	(2,872)	(2,741)	157,443	April 1, 2015	April 1, 2016 – April 1, 2020	0.92
Total for other share option holders:	**559,927**	**–**	**–**	**(2,872)**	**(366,593)**	**190,462**			
TOTAL:	**1,909,927**	**750,000**	**–**	**(2,872)**	**(366,593)**	**2,290,462**			

DIRECTORS' REPORT

Notes to the table of share options outstanding during the year:

* The vesting period of the share options is from the date of grant until the commencement of the exercise period.

** The exercise price of the share options is subject to adjustment in the case of rights or bonus issues, or other similar changes in the Company's share capital.

*** The closing prices of the Company's shares immediately before the date on which the options were granted on June 5, 2017 and June 30, 2017 were CAD$0.37 and CAD$0.33, respectively.

The directors have estimated the values of the share options granted to Messrs. Yingbin Ian He, Zhu Liu, Mao Sun and Ms. Jin Lan Quan were US$21,572, US$11,713, US$15,617 and US$11,713, respectively, during the year, calculated using Black-Scholes option pricing model as at the date of grant of the share options.

The Black-Scholes option pricing model is a generally accepted method of valuing options. The significant assumptions used in the calculation of the values of the share options were expected life of the options, risk-free interest rate, expected volatility and expected dividend yield of the shares of the Company. The measurement dates used in the valuation calculations were the dates on which the options were granted.

The value of the share options calculated using the Black-Scholes option are subject to certain fundamental limitations, due to the subjective nature of and uncertainty relating to a number of assumptions of the expected future performance input to the model, and certain inherent limitations of the model itself. The value of an option varies with different variables of certain subjective assumptions. Any change to the variables used may materially affect the estimation of the fair value of an option.

Details of the accounting policy for the Share Option Plan are set out in Note 3.11 to the Financial Statements.

Arrangement to purchase shares and debentures

Eligible Directors, employees and members of management are able to participate in the Company's share purchase plan (the "Share Purchase Plan"), which allows participants to contribute up to 7% of their basic annual salary to purchase shares in the Company. The Company contributes 50% of the participant's contribution and at the end of each calendar quarter, Shares are issued by the Company on behalf of the participants.

Save as disclosed above, at no time during the financial year was the Company, or any of its subsidiaries or fellow subsidiaries, or the holding company a party to any arrangements to enable the directors to acquire benefits by means of the acquisition of shares in , or debentures of, the Company or any other body corporate.

Substantial shareholders

The register of interests and short positions in Shares required to be kept by the Company (the "Register of Interests") showed that as at December 31, 2017, the Company has been notified of the following interests in the Shares and underlying Shares (other than those of a Director or the chief executive of the Company) representing 5% or more of the Company's issued Shares:

Name of substantial shareholders	Nature of interest	Number of Shares held [a][f]	Approximate percentage of issued Shares [e]
Land Breeze II S.a.r.l. [b]	Beneficial	64,766,591	23.76%
Fullbloom Investment Corporation [b]	Interest of a controlled corporation	64,766,591	23.76%
China Investment Corporation ("CIC") [b]	Interest of a controlled corporation	64,766,591	23.76%
Novel Sunrise Investments Limited ("Novel Sunrise") [c]	Beneficial	46,358,978	17.01%
Hope Rosy Limited [c]	Interest of a controlled corporation	46,358,978	17.01%
China Cinda (HK) Investments Management Company Limited [c]	Interest of controlled corporations	46,358,978	17.01%
China Cinda (HK) Holdings Company Limited [c]	Interest of controlled corporations	46,358,978	17.01%
China Cinda Asset Management Co., Limited [c]	Interest of controlled corporations	46,358,978	17.01%
The Ministry of Finance of the People's Republic of China ("MOF") [c]	Interest of controlled corporations	46,358,978	17.01%
Voyage Wisdom Limited [d]	Beneficial	25,768,162	9.45%

Notes:

(a) The information as to the Shares beneficially owned or controlled or directed that is not within the knowledge of the Company, its Directors or its officers has been furnished by the applicable Shareholders or has been extracted from the public filings.

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

(c) 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., Limited. China Cinda Asset Management Co., Limited is indirectly controlled by MOF. Accordingly, each of Hope Rosy Limited, China Cinda (HK) Investments Management Company Limited, China Cinda (HK) Holdings Company Limited, China Cinda Asset Management Co., Limited and MOF was deemed to be interested in Shares held by Novel Sunrise.

(d) Messrs. Aminbuhe, Guo and Li are directors of and respectively owns 45%, 10% and 45% interests in Voyage Wisdom Limited, a private company which owned 9.45% interest in the Company as at December 31, 2017.

(e) The percentage represents the total number of the Shares and the underlying Shares interested divided by the number of issued Shares as at December 31, 2017 (i.e. 272,607,299 Shares).

(f) All interests stated above are long positions.

Other than the interests as disclosed above, according to the Register of Interests, the Company has not been notified of any relevant interests or short positions in the Shares and underlying Shares as at December 31, 2017.

Management contracts

No contracts concerning the management and administration of the whole or any substantial part of the Company's business were entered into or existed during the Financial Year.

Emolument policy

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

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

The Company has also adopted the Share Option Plan to incentivize Directors and eligible employees. Details of the plan are set out in Note 28 to the Financial Statements.

Details of the emoluments of the Directors and five individuals with the highest emoluments for the Financial Year are set out in Note A1 to the Financial Statements.

Pre-emptive rights

There are no provisions for pre-emptive rights under the Articles of Continuation or under the laws of Canada which would oblige the Company to offer new Shares on a pro-rata basis to existing Shareholders.

Moreover, pursuant to the terms of a convertible debenture issued by the Company to CIC on October 26, 2009 and subsequently assigned by CIC to Land Breeze II S.a.r.l. (the "CIC Convertible Debenture"), and, subject to certain exceptions, while the CIC Convertible Debenture is outstanding or while Land Breeze II S.a.r.l. beneficially owns directly or indirectly 15% of the outstanding Shares, Land Breeze II S.a.r.l. has a pre-emptive right to subscribe for any new Common Shares offered by the Company (on a pro rata basis) while pursuant to the terms of a subscription agreement dated February 24, 2015 between the Company and Novel Sunrise, subject to certain exceptions, as long as Novel Sunrise and its affiliates own, directly or indirectly, 10% or more of the outstanding Shares, Novel Sunrise has a pre-emptive right to subscribe for any Common Shares, equity securities of the Company or securities convertible into Shares or equity securities of the Company, offered by the Company (on a pro rata basis).

Sufficiency of public float

Pursuant to the rules and regulations of the Toronto Stock Exchange, a company's securities may be delisted if the number of freely-tradable, publicly held securities is less than 500,000 or the number of public security holders, each holding a board lot consisting of 100 common shares or more, is less than 150. Based on information that is publicly available to the Company and within the knowledge of the Directors, the Company has maintained the amount of public float as approved by the Toronto Stock Exchange and Hong Kong Stock Exchange as at the date of this report.

Major customers and suppliers

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

Purchases

The largest supplier accounted for 22% of the Company's purchases.

The five largest suppliers accounted for 76% of the Company's purchases in aggregate.

Sales

The largest customer accounted for 25% of the Company's sales.

The five largest customers accounted for 71% of the Company's sales in aggregate.

At no time during the Financial Year did a Director, a close associate (as defined in the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules")) of a Director or a Shareholder (which to the knowledge of the Directors owns more than 5% of the Company's share capital) had an interest in any of the Company's five largest suppliers or five largest customers.

Charitable donations

During the Financial Year, the Company made charitable donations amounting to US$65,085 (2016: US$78,523).

Permitted Indemnities

The Company has arranged for appropriate insurance cover for the Directors' and Officers' liabilities in respect of legal actions against the Directors and senior management of the Company arising out of corporate activities.

Pursuant to the Articles of Continuation and subject to the Business Corporations Act of British Columbia, Canada, the Company must indemnify a director or former director of the Company and his or her heirs and legal personal representatives against all eligible penalties to which such person is or may be liable, and the Company must, after the final disposition of an eligible proceeding, pay the expenses actually and reasonably incurred by such person in respect of that proceeding.

Related party transactions

Related party transactions of the Company during the Financial Year are disclosed in Note 32 to the Financial Statements. They did not constitute connected transactions or continuing connected transactions, which are required to comply with the disclosure requirements in accordance with Chapter 14A of the Listing Rules.

Equity-linked agreements

Other than the Share Option Plan and the Share Purchase Plan as disclosed above and the section headed "Management's Discussion and Analysis – CIC Convertible Debenture", no equity-linked agreements that (i) will or may result in the Company issuing Shares or (ii) require the Company to enter into any agreements that will or may result in the Company issuing Shares were entered into by the Company during the Financial Year or subsisted at the end of the Financial Year.

Tax relief

The Company is not aware of any relief on taxation available to the Shareholders by reason of their holdings of the Shares. If the Shareholders are unsure about the taxation implications of purchasing, holding, disposing of, dealing in, or exercising of any rights in relation to the Shares, they are advised to consult their professional advisers.

Independent auditor

A resolution will be submitted at the 2018 AGM to re-appoint PricewaterhouseCoopers LLP as independent auditor of the Company.

On behalf of the Board

Mao Sun
Interim Independent Lead Director
March 28, 2018

CORPORATE GOVERNANCE REPORT

Corporate Governance

The board of directors of the Company (the "Directors" and the "Board", respectively) considers good corporate governance practices to be an important factor in the continued and long-term success of the Company by helping to maximize shareholders value over time.

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

- approved and adopted a mandate for the Board (the "Board Independent Mandate"), which sets out its stewardship responsibilities;
- appointed an independent non-executive director ("INED"), as interim independent Lead Director (the "Interim Independent Lead Director"), with specific responsibilities of, among other things, providing overall leadership of the Board, maintaining the independence of the Board and ensuring that the Board carries out its responsibilities mandated by applicable statutory and regulatory requirements and stock exchange listing standards, and in accordance with best practices;
- established an Audit Committee (composed of INEDs), a Nominating and Corporate Governance Committee (composed of INEDs), a Compensation and Benefits Committee (composed of INEDs) and a Health, Environment, Safety and Social Responsibility ("HESS") Committee (composed of an INED, a non-executive director and an executive director);
- reviewed and approved amendments (if any) to the Board Mandate and the respective charters for Board committees, including the Audit, Nominating and Corporate Governance, Compensation and Benefits, and HESS Committees;
- established a Disclosure Committee for the Company, comprised of members of management and the Chair of the Nominating and Corporate Governance Committee, with the mandate to oversee the Company's disclosure practices;
- reviewed and approved amendments (if any) to the Company's Disclosure Controls and Procedures, and the Corporate Disclosure and Securities Trading Policy;
- reviewed and approved amendments (if any) to the Board Diversity Policy;
- reviewed and approved amendments (if any) to the Company's Business Integrity standards, including: the Anti-Corruption Standard and the Conflicts of Interest Standard, "The Way We Work", and Guidelines for the investigation into allegations of serious wrongdoing (collectively, the "Code of Conduct Standards");
- approved and adopted a Shareholder Communication Policy;
- reviewed and approved amendments (if any) to the written position descriptions for the Chairman, Lead Director, Chief Executive Officer (the "CEO") and Chief Financial Officer (the "CFO"), as well as the Chairmen of the Audit, Nominating and Corporate Governance, Compensation and Benefits and HESS Committees clearly defining their respective roles and responsibilities;
- adopted and implemented a compliance program for all Directors and employees, including business integrity policies and the EthicsPoint whistleblowing program;
- formalized a process for assessing the effectiveness of the Board as a whole, the committees of the Board and the contribution of individual Directors, on a regular basis;
- participated in a seminar which provided an overview of rules and regulations and detailed the Company's multi-jurisdictional obligations;
- commissioned reports from independent third parties on compensation for the Company's executive management and INEDs; and
- established an independent Special Committee, which was formed in order to initiate and oversee a formal internal investigation into the charges against the Company's former Chairman and CEO and the connection, if any, between those charges and the Company and his conduct as the former Chairman and CEO of the Company.

Compliance with Corporate Governance

Throughout the year ended December 31, 2017 (the "Financial Year"), the Company has applied the principles and complied with the requirements of its corporate governance practices as determined and established by the Board and as mandated by applicable statutory, regulatory and stock exchange listing rules and standards, save as disclosed in this report. The Company's current practices are reviewed and updated regularly to ensure that the latest developments in corporate governance are followed and observed.

During the Financial Year, the Company reviewed and adopted amendments to all of the governance documents included in the Code of Conduct Standards. The Code of Conduct Standards were originally adopted and implemented in 2012. In addition to updating the Code of Conduct Standards, amendments to the Company's Disclosure Controls and Procedures and the Corporate Disclosure and Securities Trading Policy were also approved and adopted. During the Financial Year, the Company also approved and adopted the Shareholder Communication Policy and approved amendments to the Board Diversity Policy.

The Code of Conduct Standards provides that the Company's employees, consultants, officers and Directors will uphold its commitment to a culture of honesty, integrity and accountability and that the Company requires the highest standards of professional and ethical conduct from its employees, consultants, officers and Directors. The various policies forming the Code of Conduct Standards, the Shareholder Communication Policy and the Board Diversity Policy are available on the Company's website (www.SouthGobi.com) and a copy of the Code of Conduct Standards may be obtained, without charge, by request to SouthGobi Resources Ltd., at its registered and records office in Canada, 20th floor – 250 Howe Street, Vancouver, British Columbia, Canada V6C 3R8, for the attention of the Corporate Secretary, or by phone to 604-762-6783.

In 2016, the Company adopted and implemented the EthicsPoint whistleblowing program. EthicsPoint is the Company's confidential whistleblowing program, which is administered by an independent third party, and is available to the Company's personnel for use when someone suspects or is aware of any illegal, unsafe or inappropriate activity at work. EthicsPoint provides an avenue for individuals to raise concerns confidentially and anonymously.

The Nominating and Corporate Governance Committee monitors compliance with the Code of Conduct Standards and ensures systems are in place to verify compliance with legal, regulatory, corporate governance and disclosure requirements.

Pursuant to code provision E.1.2 of the Corporate Governance Code, the Chairman of the Board of Directors should attend the annual general meeting ("AGM"). Mr. Li, the former Executive Chairman, did not stand for re-election at the 2017 AGM and was unable to attend the 2017 AGM due to a prior commitment. Mr. Sun, an INED and the Interim Lead Director, acted as chairman of the 2017 AGM to ensure effective communication with the Shareholders.

Pursuant to code provision A.2.7 of the Corporate Governance Code, the chairman of the Board should at least annually hold meetings with the non-executive directors (including independent non-executive directors) without the executive directors present. There were no standalone meetings between the former Executive Chairman with the non-executive directors without the other executive directors present during the period from January 1, 2017 to June 30, 2017, being the date of the retirement of the former Executive Chairman as a director. However, the opportunity for such communication channel was always offered at the end of the Board meetings. The Company does not have a Chairman since the conclusion of the AGM held on June 30, 2017. A meeting between the Chairman (if any) or the Lead Director who is fulfilling the duties of the Chairman and the non-executive directors will be scheduled for 2018 and annually going forward.

Board Composition

In its corporate governance guidelines, the Canadian Securities Administrators (the "CSA") recommend that a majority of the directors of a corporation be independent directors. Under the CSA corporate governance guidelines, a director is independent if he or she has no direct or indirect material relationship with the Company. A "material relationship" is one which could, in the view of the Board, be reasonably expected to interfere with the exercise of the Director's independent judgment. The Company considers that a partner, shareholder or officer of an organization that has a material relationship with the Company has an indirect material relationship under the CSA corporate governance guidelines and is, therefore, not an independent Director.

CORPORATE GOVERNANCE REPORT

Based on the information regarding personal and business circumstances provided in a comprehensive questionnaire completed annually by each of the Directors and a reasonable enquiry of the Board to determine whether or not the members of the Board are independent, the Board is satisfied that four (4) of its seven (7) current members representing 57% of all Board members are independent and has determined that Messrs. He, Liu, Sun and Ms. Quan are independent. Moreover, six (6) of the seven (7) Directors are non-executive Directors.

The Board is of the view that appropriate structures and procedures are in place to allow the Board to function independently of management. In the event that the Board must consider a potential or actual conflict, such matter is referred to the INEDs and are subject to independent scrutiny. To facilitate the exercise of independent judgment, the INEDs and non-executive directors of the Board meet regularly. In 2017, the INEDs met five (5) times. During the Financial Year, the Directors were/are as follow:

Independent Non-Executive Directors
Current
Mr. Mao Sun *(Interim Independent Lead Director)*
Mr. Yingbin Ian He [1]
Mr. Zhu Liu
Ms. Jin Lan Quan

Prior Independent Non-Executive Director
Mr. Joseph Belan [5]

Prior Executive Director
Mr. Ningqiao Li [6][8]

Prior Non-Executive Director
Mr. Huiyi Wang [7]

Executive Directors
Current
Mr. Yulan Guo [2][8]

Non-Executive Directors
Current
Mr. Wen Yao [3]
Mr. Aminbuhe [4][8]

Notes:

1) Mr. He joined the Board as an INED on May 16, 2017;
2) Mr. Guo is an Executive Director and the CFO of the Company;
3) Mr. Yao joined the Board as a non-executive Director on May 18, 2017;
4) Mr. Aminbuhe was re-designated from an Executive Director to a non-executive Director on November 22, 2017. He was appointed as the Chairman on June 30, 2017 and ceased as the Chairman and the CEO on November 22, 2017;
5) Mr. Belan did not stand for re-election at the 2017 AGM and ceased to be an INED on June 30, 2017. Mr. Belan confirmed that he has no disagreement with the Board and that there were no matters which need to be brought to the attention of the Shareholders;
6) Mr. Li did not stand for re-election at the 2017 AGM and ceased to be an Executive Director and the Executive Chairman on June 30, 2017. Mr. Li confirmed that he had no disagreement with the Board and that there were no matters which need to be brought to the attention of the Shareholders;
7) Mr. Wang resigned as a non-executive Director on July 24, 2017. Mr. Wang confirmed that he had no disagreement with the Board and that there were no matters which need to be brought to the attention of the Shareholders; and
8) Messrs. Guo, Aminbuhe and Li are directors and shareholders of Voyage Wisdom Limited, a private company which owned approximately 9.45% of the Company's issued and outstanding common shares as at December 31, 2017.

As at March 28, 2018, each of China Cinda Asset Management Company Limited (through its wholly-owned subsidiary Novel Sunrise Investments Limited), China Investment Corporation ("CIC") (through its wholly-owned subsidiary Land Breeze II S.à.r.l.) and Voyage Wisdom Limited held approximately 17.01%, 23.76% and 9.45% of the Company's issued and outstanding common shares, respectively.

The Company does not currently have a Chairman. Mr. Sun, the Company's Interim Independent Lead Director and an INED, is currently fulfilling the duties of the Chairman of the Company, and is responsible for, amongst other things, maintaining the independence of the Board, ensuring that the Board carries out its responsibilities and chairing meetings of the Board. Mr. Sun has served as the Company's Interim Independent Lead Director since August 2016. Mr. Sun does not serve in a similar capacity with any other company. Mr. Bing Wang has been the Company's interim CEO since November 13, 2017, and is responsible for the Company's operations.

The Company has received confirmation from each of the INEDs of his/her independence pursuant to securities laws and listing rules in all applicable jurisdictions. The Company considers four (4) of the six (6) non-executive Directors to be independent.

To the best knowledge of the Company, none of the Directors are related, except indirectly as noted below. Relationships include financial, business or family relationships. In this regard, the Company notes that (i) Messrs. Aminbuhe and Guo are directors and shareholders of Voyage Wisdom Limited, a private company which owned 9.45% of the Company's issued and outstanding common shares as at December 31, 2017; and (ii) Mr. Yao was nominated by CIC, a substantial shareholder, for election to the Board pursuant to CIC's nomination rights under a securityholders' agreement executed by and among the Company, CIC and Turquoise Hill Resources Ltd. Each Director is free to exercise his or her independent judgment.

Mandate of the Board

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

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

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

CORPORATE GOVERNANCE REPORT

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

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

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

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

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

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

The Company has a disclosure policy addressing, among other things, the procedures and internal controls for the handling and dissemination of inside information, how the Company interacts with analysts and the public, and contains measures for the Company to avoid selective disclosure. The terms of the disclosure policy are no less exacting than those set out in the Guidelines on Disclosure of Insider Information published by the Securities and Futures Commission of Hong Kong.

The Company has a Disclosure Committee, comprised of members of management and with participation by the Chairman of the Nominating and Corporate Governance Committee, and such other advisors as may be required. The Disclosure Committee is responsible for overseeing the Company's disclosure practices, including responsibility for the controls, procedures and policies with respect to corporate disclosure. The Disclosure Committee assesses materiality and determines when developments justify public disclosure. The Disclosure Committee reviews the disclosure policy annually and as otherwise needed to ensure compliance with regulatory requirements as well as review all documents which are reviewed by the Board and the Audit Committee. The Board reviews and approves the Company's material disclosure documents, including its Annual Report, Annual Information Form and Management Proxy Circular. The Company's annual and quarterly financial statements, Management's Discussion and Analysis and other financial disclosure are reviewed by the Audit Committee and approved by the Board prior to release.

Committees of the Board

The Board has established several Board committees, namely the Audit, Nominating and Corporate Governance, Compensation and Benefits, and HESS Committees, for overseeing particular aspects of the Company's affairs. In 2017, the Board approved the formation of an independent Special Committee, which was established in order to initiate and oversee a formal internal investigation into the charges against the Company's former CEO and the connection, if any, between those charges and the Company and his conduct as the former CEO of the Company.

All the Committees, other than the Special Committee, have been established with defined written charters, which are published on the respective websites of the Company and the Hong Kong Stock Exchange, and are available to the Shareholders upon request. All the Board committees report to the Board on their decisions or recommendations made.

Audit Committee

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

The Company's Audit Committee consists of four (4) Directors, namely Messrs. He, Liu and Sun and Ms. Quan. Mr. Sun is the Chairman of the Audit Committee. Mr. He joined the Audit Committee on May 16, 2017. Mr. Belan did not stand for re-election and ceased to be a member of the Audit Committee following the conclusion of Company's 2017 AGM.

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

Although the Audit Committee has the powers and responsibilities set forth in its charter, the role of the committee is oversight. Annually, the Board reviews the Committee's charters and the Board Mandate. In 2017, the Board reviewed all of the Company's current Board committee charters and the Audit Committee charter was updated and amended to, amongst other things, incorporate the specifications included in the Corporate Governance Code. The members of the Audit Committee are not employees of the Company and may or may not be accountants or auditors by profession or experts in the fields of accounting or auditing and, in any event, do not serve in such a capacity. Consequently, it is not the duty of the Audit Committee to conduct audits or to determine that the Company's financial statements and disclosures are complete and accurate and are in accordance with generally accepted accounting principles and applicable rules and regulations. These are the responsibilities of management and the Auditors.

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

CORPORATE GOVERNANCE REPORT

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

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

- overseen the relationship with the Auditors;
- reviewed the quarterly, interim and annual financial statements;
- reviewed and assessed the effectiveness of the systems of risk management and internal controls; and
- reported to the Board on the proceedings and deliberations of the Audit Committee.

Nominating and Corporate Governance Committee

The Board has established a Nominating and Corporate Governance Committee which operates under a charter approved by the Board. In 2017, the Board reviewed all of the Company's current Board charter and the Nominating and Corporate Governance Charter was amended to reflect current best practices. The primary objective of the Nominating and Corporate Governance Committee is to assist the Board in fulfilling its oversight responsibilities by (a) identifying individuals qualified to become members of the Board and the committees of the Board and recommending that the Board selects such individuals as director nominees for appointment or election to the Board or its committee, as the case may be; and (b) developing and recommending to the Board corporate governance guidelines for the Company and making recommendations to the Board with respect to corporate governance practices. The Nominating and Corporate Governance Committee monitors the disclosure of conflicts of interest to the Board and ensures that no Director will vote or participate in a discussion on a matter in respect of which such Director has a material interest. Committee Chairs perform the same function with respect to meetings of each Board committee.

The Company's Nominating and Corporate Governance Committee consists of four (4) Directors, namely Messrs. He, Liu and Sun and Ms. Quan. Mr. He is the Chairman of the Nominating and Corporate Governance Committee. He joined the Nominating and Corporate Governance Committee on May 16, 2017 and was appointed as Chairman of the Nominating and Corporate Governance Committee on June 30, 2017. Mr. Belan did not stand for re-election and ceased to be the Chairman and member of the Nominating and Corporate Governance Committee following the conclusion of the Company's Annual General Meeting.

During the course of 2017, the Nominating and Corporate Governance Committee met nine (9) times. In performing its duties in accordance with the Nominating and Corporate Governance Committee's charter, the Nominating and Corporate Governance Committee has:

- reviewed and amended the Nominating and Corporate Governance Committee's charter to ensure that the Company has the appropriate procedures and processes in place to facilitate the nomination of Directors;
- conducted self-assessments of the Board and the Board committees;

- reviewed the structure, size and composition (including the skills, knowledge and experience, etc.) of the Board;
- made recommendations to the Board on the selection of individuals nominated for directorship in view of their qualifications and related expertise;
- made recommendations to the Board on the selection of individuals nominated for senior management roles;
- evaluated the Company's executive management succession plans;
- ensured that the Board has the necessary structures and procedures so that it can function with an appropriate degree of independence from management;
- provided a forum without management present to receive expressions of concern, including any concern regarding matters involving the independence of the Board from management;
- conducted induction programs for new Directors;
- reviewed the practices and procedures of the Board in light of ongoing developments in regulatory and stock exchange requirements and industry best practices in matters of corporate governance and recommended to the Board any changes considered necessary or desirable;
- assessed the independence of INEDs and reviewed the continuous professional development of the Directors as required by the Corporate Governance Code;
- reviewed and recommended amendments to the Company's Disclosure Controls and Procedures and the Corporate Disclosure and Securities Trading Policy;
- reviewed and recommended amendments the Board Diversity Policy;
- reviewed and approved amendments to the Company's Code of Conduct Standards, including: the Anti-Corruption Standard and the Conflicts of Interest Standard, The Way We Work, and Guidelines for the investigation into allegations of serious wrongdoing and the EthicsPoint program; and
- reviewed and recommended approval of the adoption of the Shareholder Communication Policy.

Compensation and Benefits Committee

The Board has established a Compensation and Benefits Committee which operates under a charter approved by the Board. Annually, the Board reviews the Committee's charters and the Board Mandate. In 2017, the Board reviewed all of the Company's current Board committee charters and the Compensation and Benefits Committee's charter was updated and amended to, amongst other things, incorporate the specifications included in the Corporate Governance Code. The primary objective of the Compensation and Benefits Committee is to discharge the Board's responsibilities relating to the determination of compensation and benefits for the Directors and executive officers of the Company. This role includes reviewing and approving executives' compensation including long-term incentive components and making applicable recommendations to the Board, administering the employee's Equity Incentive Plan ("EIP"), determining the recipients as well as the nature and size of equity compensation awards and bonuses granted from time to time, and reviewing reports as may be required under applicable laws and regulations.

The Company's Compensation and Benefits Committee consists of four (4) Directors, namely Messrs. He, Liu and Sun and Ms. Quan. Mr. Liu is the Chairman of the Compensation and Benefits Committee. Mr. He joined the Compensation and Benefits Committee on May 16, 2017. Mr. Belan did not stand for re-election and ceased to be a member of the Compensation and Benefits Committee following the Company's 2017 Annual General Meeting.

During the course of 2017, the Compensation and Benefits Committee met five (5) times.

In performing its duties in accordance with the Compensation and Benefits Committee's charter, the Compensation and Benefits Committee has:

- engaged Roger Gurr & Associates, a Canadian professional compensation and benefits consultancy firm, to conduct a review of the compensation program for the Company's independent non-executive Directors and executive management;
- engaged Spencer Ogden Energy, a Hong Kong based energy recruitment firm, to conduct a review of the compensation program for the Company's executive management;

CORPORATE GOVERNANCE REPORT

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

Health, Environment, Safety and Social Responsibility Committee

The Board has established a Health, Environment, Safety and Social Responsibility Committee which operates under a charter approved by the Board. In 2017, the Board reviewed all of the Company's current Board charters and the HESS Charter was amended to reflect current best practices. The primary objective of the HESS Committee is to review and oversee the Company's established HESS policies and procedures at the Company's project sites. The HESS Committee also reviews any incidents which occur and provides guidance on how to prevent any recurrences.

The Company's HESS Committee consists of three (3) Directors, namely Messrs. Aminbuhe, Guo and Liu. Mr. Aminbuhe is the Chairman of the HESS Committee.

During the course of 2017, the HESS Committee met twice.

Ad Hoc/Special Committees

In appropriate circumstances, the Board may establish a special committee to review a matter in which certain Directors or management may have a conflict of interest.

In November 2017, an independent Special Committee, comprised of Messrs. Sun and He and Ms. Quan, was formed in order to initiate and oversee a formal internal investigation into the charges against Mr. Aminbuhe and the connection, if any, between those charges and the Company and his conduct as the former Chairman and CEO of the Company. The Special Committee will report to the Board from time to time with respect to the results and status of its investigation and the potential impact of these matters, if any, on the business and affairs of the Company. Mr. Sun is the Chair of the independent Special Committee.

Pursuant to the code provision A.2.7 of the Corporate Governance Code, the Chairman should at least annually hold meetings with the non-executive Directors without the executive Directors present. There were no standalone meetings between the former Executive Chairman with the non-executive Directors and without the executive Directors present during the period from January 1, 2017 to June 30, 2017, being the date of the former Executive Chairman ceased to be a Director; however, the opportunity for such communication channel is always offered at the end of the Board meetings. The Company has not had a Chairman since June 30, 2017. A meeting between the Chairman (if any) or Lead Director, who is fulfilling the duties of the Chairman, and non-executive Directors will be scheduled for 2018 and annually going forward. During the Financial Year, the Interim Independent Lead Director met with the non-executive Directors five (5) times.

Strategic Advisory Board

In 2016, an independent Strategic Advisory Board was established to provide non-binding strategic guidance and advice to the Board in connection with the Company's ongoing business activities and initiatives. In light of the reconstitution of the Board and appointment of new directors, the Company's Strategic Advisory Board was dissolved on June 30, 2017.

Mr. Braam Jonker was the sole member of the Strategic Advisory Board and his contract with the Company was terminated effective from June 30, 2017.

Meetings of the Board and Committees of the Board

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

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During the Financial Year, there were: eleven (11) meetings of the Board, four (4) meetings of the Audit Committee, nine (9) meetings of the Nominating and Corporate Governance Committee, five (5) meetings of the Compensation and Benefits Committee, two (2) meetings of the HESS Committee and two (2) meetings of the independent Special Committee.

One AGM was held and no extraordinary general meeting of the Company was held during the Financial Year.

Attendance by the Directors at the 2017 AGM as well as Board and Board committee meetings held in the Financial Year is shown below:

Attendance record for the AGM and Board and Board Committee meetings during the Financial Year	2017 AGM	Board meetings	Audit Committee meetings	Nominating and Corporate Governance Committee meetings	Compensation and Benefits Committee meetings	HESS Committee meetings	Independent Special Committee meetings [1]
	(Number of Attendances/Number of Meetings)						
Executive Directors							
Mr. Yulan Guo [2]	1/1	11/11	N/A	N/A	N/A	1/2	N/A
Mr. Ningqiao Li [3]	0/1	3/3	N/A	N/A	N/A	N/A	N/A
Independent Non-Executive Directors							
Mr. Mao Sun *(Interim Lead Director)*	1/1	11/11	4/4	9/9	5/5	N/A	2/2
Mr. Yingbin Ian He	1/1	6/9[4]	2/2[5]	4/5[6]	2/2[7]	N/A	2/2
Mr. Zhu Liu	1/1	11/11	4/4	9/9	5/5	2/2	N/A
Ms. Jin Lan Quan	1/1	10/11	4/4	8/9	5/5	N/A	2/2
Mr. Joseph Belan	0/1	2/3[8]	2/2[8]	3/4[8]	3/3[8]	N/A	N/A
Non-Executive Directors							
Mr. Wen Yao	0/1	6/8[9]	N/A	N/A	N/A	N/A	N/A
Mr. Aminbuhe [10]	1/1	5/11	N/A	N/A	N/A	1/2	N/A
Mr. Huiyi Wang	0/1	2/4[11]	N/A	N/A	N/A	N/A	N/A

Notes:

1) The independent Special Committee was formed on November 16, 2017.

2) Mr. Guo is an Executive Director and the CFO of the Company.

3) Mr. Li did not stand for re-election at the 2017 AGM. He was the Company's Executive Chairman until the conclusion of the 2017 AGM.

4) Mr. He joined the Board as an INED on May 16, 2017 and there were nine (9) meetings of the Board following that date.

5) Mr. He joined the Audit Committee on May 16, 2017 and there were two (2) meetings of the Audit Committee following that date.

6) Mr. He joined the Nominating and Corporate Governance Committee on May 16, 2017 and there were five (5) meetings of the Nominating and Corporate Governance Committee following that date.

7) Mr. He joined the Compensation and Benefits Committee on May 16, 2017 and there were two (2) meetings of the Compensation and Benefits Committee following that date.

8) Mr. Belan did not stand for re-election at the AGM and ceased to be a member of any Board committees following the conclusion of the AGM.

9) Mr. Yao joined the Board as a non-executive Director on May 18, 2017 and there were eight (8) meetings of the Board following that date.

10) Mr. Aminbuhe was the Company's CEO until November 22, 2017. He was re-designated from an executive Director to a non-executive Director on November 22, 2017 and the Executive Chairman from June 30, 2017 to November 22, 2017.

11) Mr. Wang resigned as a non-executive Director on July 24, 2017.

The 2017 AGM was held in Vancouver, Canada on June 30, 2017 and was attended by Messrs. Aminbuhe, Guo, He and Sun in person. Ms. Quan attended the 2017 Annual General Meeting via conference call.

Professional Development

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

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

Management and outside advisors provide information and education sessions to the Board and its committees as necessary to keep the Directors up-to-date with the Company, its business and the environment in which it operates as well as with developments and best practices relating to the responsibilities of directors. Presentations are made to the Directors from time to time to educate and keep them informed of changes within the Company and of regulatory and industry requirements and standards.

As a means of facilitating continuing education opportunities for the Directors, all Directors are members of the Canadian Institute of Corporate Directors (the "ICD") and have the opportunity to attend courses relevant to the Company and its business, particularly with respect to corporate governance and the mining industry, at the Company's expense. Through the ICD, the Directors receive regular updates on numerous matters.

During the Financial Year, all of the Company's Directors had the opportunity to participate in a three-part Director Training Program webinar hosted by the Hong Kong Stock Exchange.

In 2017, Mr. Sun attended the following webinars hosted by the ICD: Fundamentals of IT Oversight, The Impact of Increasing Regulatory Oversight on Your Directors' and Officers' Insurance, Executive Compensation: Lessons from the 2017 Proxy Season, and Effective Oversight of Small Cap Companies. He also attended the 2018 BC Tax Conference.

In 2017, Ms. Quan attended the following webinars hosted by the ICD: Executive Compensation: Lessons from the 2017 Proxy Season, and Preparing for Mandatory Data Breach Reporting Requirements. In addition to the ICD webinars, Ms. Quan attended a range of professional development seminars including: Financial Strategy, a Bridge to Board Level Performance for Busy Executives, Public Trust in Tax and Economic Updates and Reports. She attended an IFRS Fundamentals seminar and a mineral exploration seminar relating to exploration and technology issues hosted by the Australian Resources research Centre.

During the Financial Year, Messrs. Aminbuhe, Guo, He, Liu and Yao continued their professional development by reviewing materials on directors' roles and functions and corporate governance practices.

Ethical Business Conduct

Throughout the Financial Year, the Company has applied the principles and complied with the requirements of its corporate governance practices as determined and established by the Board and as mandated by applicable statutory, regulatory and stock exchange listing rules and standards, save as disclosed in this report. The Company's current practices are reviewed and updated regularly to ensure that the latest developments in corporate governance are followed and observed.

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

In addition to "The Way We Work", the Company has also adopted additional guidance notes and standards which form part of the Company's overall Code of Conduct Standards. Included in the Code of Conduct Standards are the following policies and standards: the Anti-Corruption Standard and the Conflicts of Interest Standard, "The Way We Work" and Guidelines for the investigation into allegations of serious wrongdoing and the EthicsPoint program.

EthicsPoint is the Company's whistleblowing service which is administered by an independent third party provider. EthicsPoint provides an avenue for the Company's personnel to raise concerns confidentially and anonymously and it is available for use should someone suspect or is aware of any illegal, unsafe or inappropriate activity at work. Information regarding EthicsPoint is available on the Company's website (www.SouthGobi.com).

The Ethics Policy and the Code of Conduct Standards provide that the Company's employees, consultants, officers and Directors will uphold its commitment to a culture of honesty, integrity and accountability and that the Company requires the highest standards of professional and ethical conduct from its employees, consultants, officers and Directors. A copy of the Ethics Policy entitled "The Way We Work" and the various policies forming the Code of Conduct Standards are available on the Company's website (www.SouthGobi.com) and may be obtained, without charge, by request to SouthGobi Resources Ltd. at its registered and records office in Canada, 20th floor – 250 Howe Street, Vancouver, British Columbia, Canada V6C 3R8, for the attention of the Corporate Secretary, or by phone to 604-762-6783.

The Nominating and Corporate Governance Committee monitors compliance with the Code of Conduct Standards and the ensures the systems are in place to verify compliance with legal, regulatory, corporate governance and disclosure requirements.

Shareholder Communication Policy

During the Financial Year, the Board of Directors reviewed and approved the adoption of the Shareholder Communication Policy. The Shareholder Communication Policy sets out the general policy and measures adopted by the Company in respect of its communication with Shareholders, both individual and institutional, and, when appropriate, potential investors and analysts who report on and analyze the Company's performance (collectively, the "investment community"), with the objective that all of them will be provided with complete, equal, and timely information about the Company (including its financial performance, strategic goals and plans, material business developments, corporate governance, risk profile and other material information) in order to enable Shareholders to make an informed decision with respect to their shares and other securities of the Company and to allow the investment community to engage in constructive dialogue with the Company.

A copy of the Shareholder Communication Policy is available on the Company's website (www.SouthGobi.com) and may be obtained, without charge, by request to SouthGobi Resources Ltd., 20th floor – 250 Howe Street, Vancouver, British Columbia, Canada V6C 3R8, for the attention of the Corporate Secretary, or by phone to 604-762-6783.

Board Diversity Policy

The Company believes that a diverse board will enhance the decision making of the Board by utilizing the difference in skills, experience and background, geographical and industry experience, ethnicity, gender, knowledge and length of services, and other distinguishing qualities of the members of the Board. In support of this belief, the Board adopted a Board Diversity Policy in March 2014 and approved the adoption of certain amendments to the Board Diversity Policy in November 2017. All Board appointments will continue to be based on merit, having due regard to the overall effectiveness of the Board and diversity will be one of the criteria considered in determining the optimum composition of the Board. A copy of the Board Diversity Policy is available on the Company's website (www.SouthGobi.com) and may be obtained, without charge, by request to SouthGobi Resources Ltd., 20th floor – 250 Howe Street, Vancouver, British Columbia, Canada V6C 3R8, for the attention of the Corporate Secretary, or by phone to 604-762-6783.

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In accordance with the Board Diversity Policy, Ms. Jin Lan Quan joined the Board as of August 6, 2015, the Audit Committee on September 1, 2015, the Nominating and Corporate Governance Committee on December 14, 2015, and the Compensation and Benefits Committee on June 30, 2016. Ms. Quan has extensive experience in financial consulting services with specialist skills in external auditing, internal audit structuring, corporate financing, risk management and business acquisition.

The Board currently consists of six (6) men and one (1) woman, Ms. Quan, representing 14.3% of the total number of Directors.

Appointment and Re-election of Directors

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

Unless a Director dies, resigns or is removed from office in accordance with the BCBCA, the term of office of each of the incumbent Director ends at the conclusion of the next Annual General Meeting following his or her most recent election or appointment.

At every AGM, the Shareholders entitled to attend and vote at the Annual General Meeting for the election of Directors have the right to elect a Board consisting of the number of Directors for the time being set under the articles of continuation for the Company (the "Articles") and all the Directors cease to hold office immediately before such election but are eligible for re-election. If the Company fails to hold an AGM on or before the date by which the AGM is required to be held under the BCBCA or the Shareholders fail, at the Annual General Meeting, to elect or appoint any Directors, each Director then in office continues to hold office until the earlier of:

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

Securities Transactions by Directors

The Company has adopted policies 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 for Securities Transactions by Directors of Listed Issuers, Appendix 10 to the Hong Kong Listing Rules. The Company receives confirmation that the Directors have received, reviewed and agreed to abide by the terms of the Corporate Disclosure, Confidentiality and Securities Trading Policy throughout the Financial Year.

Furthermore, if a Director (a) enters into a transaction involving securities of the Company or, for any other reason, the direct or indirect beneficial ownership of, or control or direction over, securities of the Company changes from that shown or required to be shown in the latest insider report filed by the Director, or (b) the Director enters into a transaction involving a related financial instrument, the Director must, within the prescribed period, file (i) an insider report in the required form on the System for Electronic Disclosure by Insiders (SEDI) website (www.SEDI.ca) operated by the Canadian Securities Administrators and (ii) a Form 3A with the Hong Kong Stock Exchange.

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

Remuneration of Directors

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

Based on the recommendations provided in the compensation report commissioned from Roger Gurr & Associates (the "Roger Gurr Report") in 2016, the annual retainer for the Financial Year for each of the independent non-executive Directors was approved as below:

	CAD$
Independent Directors:	45,000
Audit Committee Chairman:	20,000
Nominating and Corporate Governance Committee Chairman:	20,000
Compensation and Benefits Committee Chairman:	10,000

Should the HESS Committee be chaired by an independent non-executive director, he or she would be entitled to receive the CAD$10,000 annual retainer.

The meeting fees for each of the independent non-executive Directors is CAD$1,500 for each Board and each Committee meeting attended. Directors also receive a travel allowance of CAD$2,000 per round-trip in excess of four (4) hours' travel time.

Upon joining the Board, Mr. He received 100,000 incentive stock options on June 5, 2017, which will expire after five (5) years, with a strike price of CAD$0.39 per share.

As recommended in the Roger Gurr Report, Messrs. He, Liu and Ms. Quan each received 150,000 incentive stock options on June 30, 2017, which will expire after five (5) years with a strike price of CAD$0.33 per share. In the capacity of the interim Lead Director, Mr. Sun received 200,000 incentive stock options on June 30, 2017, which expire after five (5) years with a strike price of CAD$0.33 per share.

All Directors are entitled to be reimbursed for actual expenses reasonably incurred in the performance of their duties as Directors.

Details regarding the remuneration of Directors are set out in Note A1 to the Financial Statements.

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Risk Management and Internal Controls

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

The policies and procedures of internal controls (which include financial, operational and compliance controls) are considered to be adequate and effective based on the annual review conducted by the Board through the Audit Committee.

The Company has conducted an annual review on whether there is a need for an internal audit department as there is no such department in the Company. Given the Company's relatively simple corporate and operation structure, as opposed to diverting resources to establish a separate internal audit department, the Board, supported by the Audit Committee, is directly responsible for risk management and internal control systems of the Company and for reviewing its effectiveness.

In November 2017, an independent Special Committee, comprised of Messrs. Sun and He and Ms. Quan, was formed in order to initiate and oversee a formal internal investigation into the charges against Mr. Aminbuhe and the connection, if any, between those charges and the Company and his conduct as the former CEO of the Company. The Special Committee will report to the Board from time to time with respect to the results and status of its investigation and the potential impact of these matters, if any, on the business and affairs of the Company. Mr. Sun is the Chairman of the independent Special Committee.

On an ongoing basis and annually, the Directors review the adequacy of the Company's resources, staff qualifications and experience, training programs and budget of the Company's accounting and financial reporting function. The Audit Committee reviewed the effectiveness of the Company's internal control policies as at December 31, 2017, and is of the view that the risk management and internal control systems in place are effective and adequate in safeguarding the investment of the Shareholders and the assets of the Company.

Auditors

PricewaterhouseCoopers LLP are the Auditors and are independent within the meaning of the Rules of Professional Conduct of the Institute of Chartered Accountants of British Columbia, Canada. The financial reporting responsibilities and audit report of the independent auditors are set out on page 127 of the annual report.

PricewaterhouseCoopers LLP will be nominated at the upcoming 2018 AGM for reappointment as Auditors at a remuneration to be fixed by the Board. PricewaterhouseCoopers LLP have served as the Auditors since April 3, 2012. Previously, the Auditors were Deloitte LLP.

Fees paid/payable to the external auditors, PricewaterhouseCoopers LLP and its affiliates in respect of audit and non-audit services provided during the Financial Year were approximately CAD$580,000.

These fees are detailed below:

Nature of services rendered	Fees paid/payable (CAD$000's)
Audit fees [1]	485
Audit related fees	95
Total	580

Note:

1) Fees for audit services billed relating to the Financial Year consisted of: (i) audit of the Company's annual financial statements; (ii) review of the Company's quarterly financial statements; (iii) statutory audit of the annual financial statements of the subsidiaries of the Company; and (iv) comfort letters, consents, and other services related to Canadian securities regulatory authorities' matters.

Responsibilities in Respect of the Financial Statements

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

Going Concern

In the fourth quarter of 2016, the Company initiated a plan to change the existing product mix to higher value and higher margin outputs by washing certain grades of coal in order to produce more premium semi-soft coking coal and to initiate more processing of the lower grades of coal in order to reduce the ash content and improve the selling price and margins on its thermal coal product. The construction of the wash plant was substantially completed in 2017, however the commencement of washing has been delayed to the second quarter of 2018. The current mine plan incorporates the coal washing and processing systems and contemplates significantly higher volumes of production in order to complement the Company's new product mix and sales volume targets. Such plans will require a significant level of stripping activities over the next two years and certain capital expenditures to achieve the designed production outputs. Such expenditures and other working capital requirements will require the Company to seek additional financing in the form of finance leases, debt or equity.

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 December 31, 2018, then the Company is unlikely to have sufficient capital resources or cash flows from mining operations in order to satisfy its current ongoing obligations and future contractual commitments. 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. 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. Details are set out on page 73 to page 76 of this annual report.

Company Secretaries

Ms. Allison Snetsinger was appointed as the Company's Corporate Secretary in November 2014 and was also the Company's Corporate Secretary from May 2012 to March 2014. Prior to being appointed as the Corporate Secretary, she was the Assistant Corporate Secretary from the time of the Company's Canadian initial public offering in December 2003.

Ms. Snetsinger has over 15 years' experience providing regulatory and corporate services to public and private companies, primarily in mining and resource industries. She is a member of each of the Canadian Institute of Corporate Directors and the Association of the Governance Professionals (Canada). Ms. Snetsinger has participated in over 15 hours' of professional development in the Financial Year required under Rule 3.29 of the Hong Kong Listing Rules.

The Company has also appointed Mr. Siu Man Kwok as Hong Kong Company Secretary of the Company. He is a fellow member of each of the Institute of Chartered Secretaries and Administrators and the Institute of Financial Accountants in England, the Institute of Public Accountants in Australia, The Hong Kong Institute of Chartered Secretaries, The Association of Hong Kong Accountants and The Hong Kong Institute of Directors. As Mr. Kwok was first appointed as the company secretary of a Hong Kong Hang Seng Index constituent stock company in 1991 and has been acting in such capacity for a number of other reputable companies listed on the Hong Kong Stock Exchange for a substantial amount of time, he was not required to have at least 15 hours of relevant continuous professional development training for each of the five consecutive years from 2012. Mr. Kwok had delivered and attended over 15 hours' relevant seminars in the Financial Year under Rule 3.29 of the Hong Kong Listing Rules.

Mr. Kwok was nominated by Boardroom Corporate Services (HK) Limited ("Boardroom") to assume such office and Boardroom has been providing certain corporate secretarial services to the Company pursuant to an engagement letter entered into between the Company and Boardroom. The primary person at the Company with whom Mr. Kwok has been contacting in respect of company secretarial matters is Ms. Allison Snetsinger, the Company's Corporate Secretary.

Shareholders' Rights

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

In November 2017 the Board approved and adopted a Shareholder Communication Policy. The Shareholder Communication Policy sets out the general policy and measures adopted by the Company in respect of its communication with Shareholders, both individual and institutional, and, when appropriate, potential investors and analysts who report on and analyze the Company's performance, with the objective that all of them will be provided with complete, equal, and timely information about the Company (including its financial performance, strategic goals and plans, material business developments, corporate governance, risk profile and other material information) in order to enable Shareholders to make an informed decision with respect to their shares and other securities of the Company and to allow the investment community to engage in constructive dialogue with the Company.

Further to the Shareholder Communication Policy, the section below entitled "Procedures by which enquiries may be put to the Board" also provides a basis for how Shareholders' can communicate with the Company.

How Shareholders Can Convene an Extraordinary General Meeting

Shareholders may requisition a meeting for the purpose of transacting any business that may be transacted at a general meeting. The Shareholder or a group of Shareholders are required to hold (on the date of giving the requisition to the Company) an aggregate of at least 1/20 (five per cent (5%)) of the Company's issued and outstanding common shares.

A valid requisition must:

- state the business to be transacted at the meeting (including the wording of any special resolution or exceptional resolution) in 1,000 words or less;
- be signed by and include the names and mailing addresses of all the requisitioning Shareholders, each of whom is a registered Shareholder;
- be made in a single record or several records, each of which is signed by one or more of the requisition Shareholders; and
- be delivered to the delivery address or mailed by registered mail to the mailing address of the Company at its registered office.

The Company's address for delivery is: SouthGobi Resources Ltd., 20th floor – 250 Howe Street, Vancouver, British Columbia, Canada V6C 3R8, for the attention of the Corporate Secretary.

If the requisition consists of more than one record, the requisition is deemed to be received by the Company on the first date by which the Company received requisition records that comply with the above-listed conditions and by the Shareholders holding the minimum number of shares to qualify for the requisition.

On receiving a valid requisition, the Board must, except in the circumstances specified in the BCBCA, call a general meeting to be held not more than four (4) months after the date on which the Company receives the requisition. The notice of the meeting and the information circular must include the date, time, location and text of the business to be approved. If the Board does not call a meeting within 21 days after the date of receiving a valid requisition, the requisitioning Shareholders or any one of them holding more than 1/40 (two and a half per cent (2.5%)) of the Company's issued and outstanding common shares may send notice of a general meeting to transact the business stated in the requisition.

A general meeting called by the requisitioning Shareholders must be held within four (4) months of the Company receiving the requisition notice and must be conducted in the same manner as a general meeting called by the Board.

Unless the Shareholders otherwise resolve by an ordinary resolution at the meeting called, the Company must reimburse the requisitioning Shareholders for the expenses reasonably incurred by them requisitioning, calling and holding the meeting.

The quorum for meetings of the Shareholders is set forth in the Articles. A quorum for a meeting of the Shareholders is two persons who are, or who represent by proxy, Shareholders who, in the aggregate, hold at least five per cent (5%) of the Company's issued and outstanding common shares.

Procedures by Which Enquiries May Be Put to the Board

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

Should a Shareholder wish to communicate with the Board, they can contact the Company's Corporate Secretary at SouthGobi Resources Ltd., 20th floor – 250 Howe Street, Vancouver, British Columbia, Canada V6C 3R8, or by phone to 604-762-6783.

Procedures for Putting Forward Proposals at Shareholders' Meetings

A qualified Shareholder (as herein defined) may put forward a written proposal setting out a matter that the qualified Shareholder wishes to have considered at the next AGM. A "qualified Shareholder" is a Shareholder who is, and who has been for an uninterrupted period of at least two (2) years before the date of the signing of the proposal, a holder or beneficial owner of the Company's issued and outstanding common share(s) (subject to certain exceptions).

A valid proposal must be signed by the submitter and by qualified Shareholder(s) (each, a "Supporter") who, together with the submitter, is/are holders of common shares that, at the time of signing, in the aggregate constitute at least one per cent (1%) of the Company's issued and outstanding common shares. A declaration signed by the submitter and each Supporter, must accompany the proposal, providing contact details and shareholdings of the submitter or the Supporter, as the case may be.

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

Constitutional Documents

There were no changes in the constitutional documents of the Company during the Financial Year. The Articles are available on the respective websites of the Company and the Hong Kong Stock Exchange.


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A LARGE RESOURCE AND RESERVES BASE

As a result of work performed by Dragon Mining Consulting Limited for the Ovoot Tolgoi deposit, the Company's aggregate coal resources include measured and indicated mineral resources of 194.6 million tonnes and inferred resources of 32.1 million tonnes while 114.1 million tonnes were declared as mineral reserves.

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

Forward-Looking Statements

Except for statements of fact relating to SouthGobi Resources Ltd. and its subsidiaries (collectively, 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 relate to management's future outlook and anticipated events or results and are based on the opinions and estimates of management at the times the statements are made. Forward-looking statements in this Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") 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 consolidated financial statements and the impact thereof;
- the Company's expectations of sufficient liquidity and capital resources to meet its ongoing obligations and future contractual commitments, including the Company's ability to settle its trade payables, 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 equipment loan and the bank loan, as the same become due;
- the Company's anticipated financing needs, development plans and future production levels;
- the Company successfully negotiating a deferral of the November 19th Payments and the November 2017 PIK Interest (as such terms are defined below) under the June 2017 Deferral Agreement and CIC Convertible Debenture;
- the ability of the Company to successfully negotiate with First Concept Industrial Group Limited (formerly known as First Concept Logistics Limited) ("First Concept") regarding payment arrangements in respect of the Arbitration Award (as defined below) that are practical to and are in the best interest of the Company;
- the ability of the Company to successfully defend itself against any enforcement proceeding brought by First Concept in respect of the Arbitration Award;
- the ability of the Company to negotiate favorable repayment terms on the TRQ Reimbursable Amount (as described under Section 6 of this MD&A under the heading entitled "*Liquidity and Capital Management – Costs Reimbursable to Turquoise Hill*");
- the results and impact of the Ontario class action (as described under Section 7 of this MD&A under the heading entitled "*Regulatory Issues and Contingencies – Class Action Lawsuit*");
- the estimates and assumptions included in the Company's impairment analysis and the possible impact of changes thereof;
- the agreement with Ejin Jinda and the payments thereunder;
- the commencement of the washing facilities at Ovoot Tolgoi and the timing thereof;
- the ability to enhance the product value by conducting coal processing and coal washing;
- the development of the Ceke Logistics Park Project (as described under Section 1 of the MD&A under the heading "*Ceke Logistics Park Project*");
- the results of the internal investigation conducted by the Special Committee (as defined below) and the potential impact of the charges against Mr. Aminbuhe and the connection, if any, between those charges and the Company and his conduct as Chairman and Chief Executive Officer of the Company;
- the evaluation, and potential pursuit of, business opportunities other than coal mining, coal trading and real estate in Mongolia, including but not limited to the Ceke Logistic Park Project, power generation and contract mining;

Forward-Looking Statements continued

- 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 Company's outlook and objectives for 2018 and beyond (as more particularly described under Section 15 of this MD&A under the heading entitled "*Outlook*"); and
- other statements that are not historical facts.

Forward-looking information is based on certain factors and assumptions described below and elsewhere in this MD&A, including, among other things: the current mine plan for the Ovoot Tolgoi mine; mining, production, construction and exploration activities at the Company's mineral properties; the costs relating to anticipated capital expenditures; the capacity and future toll rate of the paved highway; plans for the progress of mining license application processes; mining methods; timing of the commencement of the washing facilities at Ovoot Tolgoi; the Company's anticipated business activities, planned expenditures and corporate strategies; management's business outlook, including the outlook for 2018 and beyond; currency exchange rates; operating, labour and fuel costs; the anticipated royalties payable under Mongolia's royalty regime; the future coal market conditions in China and the related impact on the Company's margins and liquidity; future coal prices, and the level of worldwide coal production. While the Company considers these assumptions to be reasonable based on the information currently available to it, they may prove to be incorrect. Forward-looking statements 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 risks and uncertainties include, among other things: the uncertain nature of mining activities, actual capital and operating costs exceeding management's estimates; variations in mineral resource and mineral reserve estimates; failure of plant, equipment or processes to operate as anticipated; the possible impacts of changes in mine life, useful life or depreciation rates on depreciation expenses; risks associated with, or changes to regulatory requirements (including environmental regulations) and the ability to obtain all necessary regulatory approvals; the potential expansion of the list of licenses published by the Government of Mongolia covering areas in which exploration and mining are purportedly prohibited on certain of the Company's mining licenses; the Government of Mongolia designating any one or more of the Company's mineral projects in Mongolia as a Mineral Deposit of Strategic Importance; continued delays in the custom clearance process at the Ceke border; the Company being in default under the CIC Convertible Debenture and the TRQ Loan, including the risk of CIC accelerating all amounts outstanding under the CIC Convertible Debenture and enforcing payment thereof, and the risk of Turquoise Hill demanding immediate payment of all amounts outstanding under the TRQ Loan; the risk of the Company failing to successfully negotiate a deferral of the November 19th Payments and the November 2017 PIK Interest under the June 2017 Deferral Agreement and CIC Convertible Debenture; the possible impact of changes to the inputs to the valuation model used to value the embedded derivatives in the CIC Convertible Debenture; the risk of the Company failing to successfully negotiate favorable repayment terms on the TRQ Reimbursable Amount (as described under Section 6 of this MD&A under the heading entitled "*Liquidity and Capital Management – Costs Reimbursable to Turquoise Hill*"); the risk of the Company defaulting under its existing debt obligations, including the equipment loan and bank loan; the impact of amendments to, or the application of, the laws of Mongolia, China and other countries in which the Company carries on business; modifications to existing practices so as to comply with any future permit conditions that may be imposed by regulators; delays in obtaining approvals and lease renewals; the risk of fluctuations in coal prices and changes in China and world economic conditions; the risk of the Company failing to successfully negotiate with First Concept regarding payment arrangements in respect of the Arbitration Award; risk that First Concept may apply to enforce the Arbitration Award against SouthGobi Sands LLC ("SGS"), a subsidiary of the Company, through judicial measures in courts of Mongolia or in other applicable jurisdiction(s); and the ability of the Company to successfully defend itself against such enforcement proceedings; the outcome of the Class Action (as described under Section 6 of this MD&A under the heading entitled "*Regulatory Issues and Contingencies – Class Action Lawsuit*") and any damages payable by the Company as a result; the result of the internal investigation conducted by the Special Committee (as defined below) and the impact thereon on the Company; the risk that the calculated sales price determined by the Company for the purposes determining of the amount of royalties payable to the Mongolian government is deemed as being "non-market" under Mongolian tax law; customer credit risk; cash flow and liquidity risks; risks relating to the development of the Ceke Logistics Park project, including the risk that its investment partner may not comply with the underlying agreements governing project development and may fail to meet its obligations to the Company or third parties; risks relating to timing of the commencement of the washing facilities at Ovoot Tolgoi, including identifying a reliable water source to permit operation of the washing facilities; risks relating to the Company's ability to raise additional financing and to continue as a going concern. Please see Section 14 of this MD&A under the heading entitled "*Risk Factors*" for a discussion of these and other risks and uncertainties relating to the Company and its operations. This list is not exhaustive of the factors that may affect any of the Company's forward-looking statements.

Forward-Looking Statements continued

Due to assumptions, risks and uncertainties, including the assumptions, risks and uncertainties identified above and elsewhere in this MD&A, actual events may differ materially from current expectations. The Company uses forward-looking statements because it believes such statements provide useful information with respect to the currently expected future operations and financial performance of the Company, and cautions readers that the information may not be appropriate for other purposes. 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 the forward-looking statements, which speaks only as of the date of this MD&A; they should not rely upon this information as of any other date.

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INTRODUCTION

This MD&A is dated as of March 28, 2018 should be read in conjunction with the consolidated financial statements of the Company and the notes thereto for the year ended December 31, 2017. The Company's consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

The consolidated financial statements are presented in the U.S. Dollar, which is the functional currency of SouthGobi Resources Ltd. and its controlled subsidiaries, except as subsequently mentioned. 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 the four 100% owned Chinese subsidiaries, SouthGobi Trading (Beijing) Co., Ltd., Inner Mongolia SouthGobi Energy Ltd., Inner Mongolia SouthGobi Enterprise Co. Ltd. and Chongqing SouthGobi Energy Ltd. are Chinese Renminbi ("RMB"). All figures in this MD&A are presented in U.S. dollars unless otherwise stated.

Introduction continued

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 individuals set out in the table below, each of whom is a "Qualified Person" as that term is defined in National Instrument 43-101 – *Standards of Disclosure for Mineral Projects* ("NI 43-101") of the Canadian Securities Administrators:

Property	Qualified Persons	Field of Expertise	Relationship to Company
Ovoot Tolgoi	Dr. Weiliang Wang	Resources	Independent Consultant
Ovoot Tolgoi	Vincent Li	Reserves	Independent Consultant
Soumber	Merryl Peterson	Resources	Independent Consultant
Zag Suuj	Merryl Peterson	Resources	Independent Consultant

Disclosure of a scientific or technical nature relating to the Ovoot Tolgoi Mine contained in this MD&A is derived from a technical report (the "Ovoot Tolgoi Technical Report") prepared in accordance with NI 43-101 on the Ovoot Tolgoi Mine dated May 15, 2017, prepared by Dr. Weiliang Wang, Mr. Vincent Li and Mr. Larry Li of Dragon Mining Consulting Limited ("DMCL"). A copy of the Ovoot Tolgoi Technical Report is available under the Company's profile on SEDAR at www.sedar.com.

Disclosure of a scientific or technical nature relating to the Soumber Deposit contained in this MD&A is derived from a technical report (the "Soumber Technical Report") prepared in accordance with NI 43-101 on the Soumber Deposit dated March 25, 2013, prepared by Minarco-MineConsult and scientific and technical disclosure relating to the Zag Suuj Deposit is derived from a technical report (the "Zag Suuj Technical Report") prepared in accordance with NI 43-101 on the Zag Suuj Deposit dated March 25, 2013, prepared by Minarco-MineConsult. Copies of the Soumber Technical Report and the Zag Suuj Technical Report are available under the Company's profile on SEDAR at www.sedar.com. These reports are effective as at these dates. Minarco-MineConsult has not reviewed or updated these reports since the date of publishing.

1. Overview

The Company is an integrated coal mining, development and exploration company with 489 employees as at December 31, 2017. The Company's common shares ("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 a 100% interest in 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, all of which are located within 150 kilometers ("km") of each other and in close proximity to the Mongolia-China border.

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. The Company sells a portion of its coal at the mine-gate to Chinese customers, while the remaining coal inventory is transported to China and sold via our Chinese subsidiaries at the stockyards in Ceke (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 China) or certain designated locations in China as requested by the customers.

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 content product is sold as a thermal coal product as and when the market allows.

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

1. Overview continued

Significant Events and Highlights

The Company's significant events and highlights for the year ended December 31, 2017 and the subsequent period to March 28, 2018 are as follows:

- ***Operating Results*** – As a result of improved market conditions and prices for coal in China, the Company experienced an increase in the average selling price of coal from $16.44 per tonne in 2016 to $28.31 per tonne in 2017. The volume of coal sales has also increased from 3.91 million tonnes in 2016 to 4.65 million tonnes in 2017.

- ***Financial Results*** – The Company recorded a gross profit of $15.1 million in 2017 compared to a gross loss of $28.6 million in 2016 while $16.8 million loss from operations was recorded in 2017 compared to a $38.1 million loss from operations in 2016. Revenue increased from $58.5 million in 2016 to $121.0 million in 2017. As a result of improved market conditions and prices for coal in China, the overall financial results improved when compared to 2016, which was principally attributable to increased coal sales as well as higher average selling price achieved during the year.

- ***CIC Convertible Debenture*** – Pursuant to the terms of the deferral agreement dated June 12, 2017 (the "June 2017 Deferral Agreement") with CIC in relation to a revised payment schedule on the $22.3 million of cash interest and associated costs originally due under the CIC Convertible Debenture on May 19, 2017 (the "May 2017 Interest Payable"), the Company was required to pay $9.7 million of cash interest and associated costs to CIC on November 19, 2017 (the "June 2017 Deferral Agreement Payment"). In addition, pursuant to the terms of the CIC Convertible Debenture, the Company was required to pay $8.1 million of anniversary cash interest to CIC on November 19, 2017 (the "November Interest Payment" and together with the June 2017 Deferral Agreement Payment, the "November 19th Payments"). Pursuant to the CIC Convertible Debenture, the Company was also obliged to issue $4.0 million worth of PIK interest shares (the "November 2017 PIK Interest") to CIC on November 19, 2017.

  As of the date of this MD&A, the Company: (i) has neither paid the November 19th Payments nor issued the November 2017 PIK Interest shares to CIC within the cure period provided for under the CIC Convertible Debenture; and (ii) has not agreed upon a repayment plan for such amounts with CIC. Consequently, the Company is in default under the CIC Convertible Debenture and the June 2017 Deferral Agreement. Pursuant to the terms of the CIC Convertible Debenture and the June 2017 Deferral Agreement, CIC may, at its discretion, provide notice to the Company and declare all principal, interest and other amounts owing under the CIC Convertible Debenture and the June 2017 Deferral Agreement immediately due and payable, and take steps to enforce payment thereof, which would have a material adverse effect on the business and operations of the Company and may negatively affect the price and volatility of the Common Shares and any investment in such shares could suffer a significant decline or total loss in value. As of the date of this MD&A, the Company has received no indication from CIC of any intention to deliver a notice of default under the CIC Convertible Debenture and the June 2017 Deferral Agreement or to accelerate the amounts outstanding under the CIC Convertible Debenture and the June 2017 Deferral Agreement.

  The Company is in discussions with CIC for a deferral of the November 19th Payments and the November 2017 PIK Interest; however, there can be no assurance that a favorable outcome will be reached.

1. Overview continued

Significant Events and Highlights continued

As a consequence of the Company not entering into a deferral agreement with CIC as at December 31, 2017, International Accounting Standard 1 ("IAS 1") requires the Company to classify the entire balance of the CIC Convertible Debenture as a current liability as at December 31, 2017, notwithstanding the fact that CIC has not indicated any intention to deliver notice of default or accelerate the maturity of the CIC Convertible Debenture. The Company anticipates that both the debt host and the fair value of the embedded derivative will be classified as a non-current liability upon the execution of a deferral agreement, unless a future event of default occurs under the terms of the CIC Convertible Debenture.

- ***Notice of Arbitration*** – On January 10, 2018, the Company received a confidential partial award (final except as to costs) (the "Arbitration Award") with respect to an arbitration proceeding in Hong Kong related to a dispute concerning a coal supply agreement between SGS and First Concept.

  Pursuant to the Arbitration Award, SGS has been ordered to repay the sum of $11.5 million (which SGS had received as a prepayment for the purchase of coal) to First Concept, together with accrued interest at a simple interest rate of 6% per annum from the date which the prepayment was made until the date of the Arbitration Award, and then at a simple interest rate of 8% per annum until full payment. The Arbitration Award is final, except as to costs which have been reserved for a future award. As at December 31, 2017, the Company recorded a provision of $13.9 million for the commercial arbitration.

  On March 23, 2018, SGS received a notice from First Concept demanding payment of the full amount of the Arbitration Award, together with the accrued interest thereon, by no later than March 30, 2018, otherwise First Concept intends to commence enforcement proceedings against SGS in respect of the Arbitration Award. The Company is currently considering and reviewing its options with respect to the Arbitration Award, including exploring ways to work together with First Concept on payment arrangements that are practical to and are in best interests of both parties; however, there can be no assurance that a favorable outcome will be reached. In the event that First Concept applies to enforce the Arbitration Award against SGS through judicial measures in courts of Mongolia or in other applicable jurisdiction(s), the Company intends to defend itself against such enforcement proceedings through independent litigation counsel retained by the Company for this purpose. However, due to the inherent uncertainties of litigation, it is not possible to predict whether the Company will be successful in defending itself against any such enforcement proceedings.

- ***Tax Investigation Case in Mongolia*** – On January 10, 2018, SGS was informed by the Court Decision Implementation Agency of Capital City in Mongolia that the enforcement procedure in relation to the previously disclosed judgment of the Mongolian Second Criminal Court (the "Tax Verdict") rendered against SGS in January 2015 has been terminated and no party shall have any right to make any further claims in connection with the Tax Verdict. As of the date hereof, SGS has fulfilled its obligations under the Tax Verdict.

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

1. Overview continued

Significant Events and Highlights continued

- ***Settlement of Lawsuit Notice from a Former Fuel Supplier*** – On January 20, 2017, SGS received a notice from the Khan-Uul District Civil Court of First Instance in Mongolia (the "DC Court") in relation to a claim for damages from Magnai Trade LLC ("MTLLC"), a former fuel supplier of SGS, in the aggregate amount of MNT 22.2 billion (approximately $8.9 million) representing outstanding fuel supply payments and related penalties and interest costs. On January 25, 2017, the DC Court dismissed the litigation and the matter was referred to arbitration. The Company signed a settlement agreement with MTLLC on February 10, 2017, pursuant to which SGS would pay MTLLC $8.0 million in equal monthly installments from March 2017 to June 2017 in full satisfaction of the debt outstanding. The terms of the settlement agreement was subsequently acknowledged by the arbitrator in the arbitration award.

  On June 30, 2017, the Company signed a triparty settlement agreement (the "Triparty Settlement Agreement") with MTLLC and ICIC (an independent fuel supplier of the Company), pursuant to which: (i) MTLLC transferred to ICIC its right to receive payment from the Company for the outstanding balance of approximately $8.0 million owing under the settlement agreement dated February 10, 2017 (the "Outstanding Amount") and its right to enforce the arbitration award against the Company; and (ii) the Company and ICIC agreed to a revised payment schedule for repayment of the Outstanding Amount. Pursuant to the Triparty Settlement Agreement, the Company agreed to pay interest on the Outstanding Amount, which accrues at a monthly rate of 1.8% and will be settled on a monthly basis. The Company was required to repay on average $1.3 million monthly during the period from July 2017 to November 2017.

  As of the date of this MD&A, the Company has fulfilled its obligations under the Triparty Settlement Agreement and has fully repaid the Outstanding Amount.

- ***Class Action Lawsuit*** – On September 18, 2017, the Ontario Court of Appeal dismissed the Company's appeal of the original Ontario lower court decision to permit the plaintiff to commence and proceed with a class action (the "Class Action") against the Company claiming damages under the Ontario Securities Act in connection with the Company's restatement of certain financial statements previously disclosed in the Company's public fillings (the "Restatement"). Concurrently, the Ontario Court of Appeal allowed the plaintiff's appeal of the original Ontario lower court decision to dismiss the plaintiff's leave motion against certain of the Company's former officers and directors and made an order granting leave for the plaintiff to proceed against such former officers and directors of the Company in relation to the Restatement. As a result, the plaintiff is now permitted to proceed with the Class Action against both the Company and the former officers and directors of the Company.

  The Company has filed an application for leave to appeal to the Supreme Court of Canada in November 2017. Leave to appeal is expected to be decided by May 2018. If leave to appeal is granted, the appeal would likely be scheduled to be heard in early 2019.

- ***Ceke Logistics Park Project*** – On October 10, 2017, the Company entered into an investment agreement (the "Investment Agreement") with Beijing De Rong Tai Investment Co., Ltd. ("BDRT") in connection with the Company's development of the Ceke Port Eco-friendly Bonded Logistics Park project (the "Ceke Logistics Park"). Pursuant to the Investment Agreement, BDRT has agreed, subject to fulfilment of certain conditions, to invest RMB231 million in installment by July 30, 2018 in return for a 30% interest in Inner Mongolia SouthGobi Enterprise Co. Ltd. ("IMSE"), while the Company will hold the remaining 70% interest in IMSE. Proceeds from BDRT's equity investment will be used by IMSE for the construction of the Ceke Logistics Park. IMSE is the project company which holds a 100% interest in the Ceke Logistics Park. As of the date of the MD&A, IMSE has received RMB15 million from BDRT pursuant to the Investment Agreement.

1. Overview continued

Significant Events and Highlights continued

- ***Novel Sunrise Investments Limited ("Novel Sunrise") Sold 25.8 million Shares to a Company Owned by Members of Management*** – On January 11, 2017, Novel Sunrise, the Company's largest shareholder at the time, reported that it had sold 25.8 million Common Shares of the Company effective December 31, 2016 to Voyage Wisdom Limited ("Voyage Wisdom"), a company owned by three members of the Company's management team, for consideration of $24 million.

- ***Equipment Loan*** – Inner Mongolia SouthGobi Energy Ltd., a subsidiary of the Company executed a $10.4 million loan agreement on August 31, 2017 with Beijing Jin Rui Tian Chen Asset Management Co Ltd. for the purpose of financing the purchase of mining equipment to increase the production capacity of the Company. As at December 31, 2017, the outstanding principal and accrued interest for the Equipment Loan amounted to $2.3 million and $0.1 million, respectively (December 31, 2016: nil).

- ***Changes in Management and Director***

  Mr. Yingbin Ian He: Mr. He was appointed as an independent non-executive director on May 16, 2017.

  Mr. Wen Yao: Mr. Yao was appointed as a non-executive director on May 18, 2017.

  Mr. Joseph Belan: Mr. Belan did not stand for re-election at the Company's Annual General Meeting (the "AGM") and ceased to be an independent non-executive director on June 30, 2017.

  Mr. Ningqiao Li: Mr. Li did not stand for re-election at the AGM and ceased to be an executive director and the Executive Chairman of the Board of Directors of the Company (the "Board") on June 30, 2017.

  Mr. Huiyi Wang: Mr. Wang resigned as a non-executive director on July 24, 2017.

  Mr. Aminbuhe: Mr. Aminbuhe commenced a leave from his role as the Chief Executive Officer of the Company effective as of November 13, 2017. The Board subsequently terminated the employment of Mr. Aminbuhe due to his incapability to fulfil his daily duties and responsibilities as the Chief Executive Officer of the Company effective as of November 22, 2017. Mr. Aminbuhe was also removed as the Chairman of the Board, but remains on the Board as a non-executive director of the Company.

  The Company learned that Mr. Aminbuhe was arrested on October 11, 2017 and is being detained at Rizhao City Detention Center in China as a suspect in a fraudulent loan case. The Board has formed a special committee of independent non-executive directors (the "Special Committee") to initiate a formal internal investigation into the charges against Mr. Aminbuhe and the connection, if any, between those charges and the Company and his conduct as Chairman and Chief Executive Officer of the Company, which includes engaging external advisors to assist in the investigation. The Special Committee is required to report to the Board from time to time with respect to the results and status of its investigation and the potential impact of these matters, if any, on the business and affairs of the Company.

  Mr. Bing Wang: Mr. Wang was appointed as interim Chief Executive Officer of the Company, effective as of November 13, 2017.

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

1. Overview continued

Significant Events and Highlights continued

- ***Strategic Advisory Board*** – In light of the reconstitution of the Board and appointment of new directors, the Company's Strategic Advisory Board was dissolved on June 30, 2017.

- ***Going Concern*** – In the fourth quarter of 2016, the Company initiated a plan to change the existing product mix to higher value and higher margin outputs by commencing the washing of certain grades of coal in order to produce more premium semi-soft coking coal upon the successful commissioning of the coal washing facility under construction at the mine and to initiate more processing of the lower grades of coal in order to reduce the ash content and improve the selling price and margins on its thermal coal product. The construction of the wash plant was substantially completed in 2017, however, the commencement of washing has been delayed to the second quarter of 2018. The current mine plan incorporates the coal washing and processing systems and contemplates significantly higher volumes of production in order to complement the Company's new product mix and sales volume targets. Such plans will require a significant level of stripping activities over the next two years and certain capital expenditures to achieve the designed production outputs. Such expenditures and other working capital requirements will require the Company to seek additional financing in the form of finance leases, debt or equity.

  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 December 31, 2018, then the Company is unlikely to have sufficient capital resources or cash flows from mining operations in order to satisfy its current ongoing obligations and future contractual commitments. 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.

  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 6 of this MD&A under the heading entitled "Liquidity and Capital Resources" and Section 14 of this MD&A under the heading entitled "Risk Factors" for details. As at March 28, 2018, the Company had $7.1 million of cash.

2. Selected Annual Information

$ in thousands, except per share and per tonne information	**Year ended December 31, 2017**	2016	2015
Revenue [i]	**$ 120,973**	$ 58,450	$ 16,030
Loss from operations	**(16,774)**	(38,107)	(166,917)
Net loss	**(40,021)**	(60,846)	(186,765)
Basic and diluted loss per share	**$ (0.15)**	$ (0.24)	$ (0.79)
Cash from/(used in) operating activities	**25,731**	2,761	(10,014)
Cash used in investing activities	**(18,686)**	(1,530)	(8,572)
Cash from/(used in) financing activities	**(1,661)**	(579)	15,202
Coal sales volumes *(millions of tonnes)* [ii]	**4.65**	3.91	1.07
Average realized selling price *(per tonne)* [iii]	**$ 28.31**	$ 16.44	$ 17.66

$ in thousands	**As at December 31, 2017**	2016	2015
Cash and cash equivalents	**$ 6,471**	$966	$ 377
Total working deficiency	**(166,321)**	(59,425)	(42,322)
Total assets	**260,567**	259,321	290,474
Total non-current liabilities	**5,554**	96,706	95,137

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

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

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

The coal market in China was challenging in 2015 with certain coal price indices in China reaching the lowest level in recent years. In 2015, the Company generated revenue of $16.0 million from mining activities at the Ovoot Tolgoi Mine. The Company recorded $92.7 million of impairment charges to reduce various items of property, plant and equipment to their recoverable amounts in 2015.

Market conditions and prices for coal remained weak in China during the first half of 2016 despite a modest recovery of the general coal market in China in the second half. The improvement followed the implementation of China's national policy to reduce its coal production in order to accelerate supply-side reform and thereby seek to resolve the overcapacity issue in the medium term. The Company managed an increase in coal sales volume from 1.07 million tonnes in 2015 to 3.91 million tonnes in 2016. Although the average selling price remained challenged throughout 2016, the Company expanded its sales network and increase the number of customers from 5 in 2015 to 19 in 2016.

The market situation continued to improve in 2017. The Company experienced an increase in the average selling price of coal from $16.44 per tonne for 2016 to $28.31 for 2017. Despite the delays in the custom clearance process at the Ceke border which the Company has been experiencing since July 2017, the volume of coal sales has increased from 3.91 million tonnes for 2016 to 4.65 million tonnes from 20 customers for 2017.

3. Overview of Operational Data and Financial Results

Summary of Annual Operational Data

	Year ended December 31, 2017	2016
Sales Volumes, Prices and Costs		
Premium semi-soft coking coal		
Coal sales *(millions of tonnes)*	**0.86**	0.28
Average realized selling price *(per tonne)* (i)	**$ 47.84**	$ 31.14
Standard semi-soft coking coal		
Coal sales *(millions of tonnes)*	**2.44**	2.52
Average realized selling price *(per tonne)* (i)	**$ 28.72**	$ 16.71
Thermal coal		
Coal sales *(millions of tonnes)*	**1.35**	1.11
Average realized selling price *(per tonne)* (i)	**$ 15.24**	$ 12.16
Total		
Coal sales *(millions of tonnes)*	**4.65**	3.91
Average realized selling price *(per tonne)* (i)	**$ 28.31**	$ 16.44
Raw coal production *(millions of tonnes)*	**6.38**	3.38
Cost of sales of product sold *(per tonne)*	**$ 22.77**	$ 22.26
Direct cash costs of product sold *(per tonne)* (ii)	**$ 9.32**	$ 8.66
Mine administration cash costs of product sold *(per tonne)* (ii)	**$ 2.80**	$ 2.32
Total cash costs of product sold *(per tonne)* (ii)	**$ 12.12**	$ 10.98
Other Operational Data		
Production waste material moved *(millions of bank cubic meters)*	**20.79**	7.38
Strip ratio *(bank cubic meters of waste material per tonne of coal produced)*	**3.26**	2.18
Lost time injury frequency rate (iii)	**0.03**	0.00

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

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

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

3. Overview of Operational Data and Financial Results continued

Overview of Annual Operational Data continued

As at December 31, 2017, the Company had a lost time injury frequency rate of 0.03 per 200,000 man hours based on a rolling 12 month average.

As a result of improved market conditions and prices for coal in China, the Company experienced an increase in the average selling price of coal as compared to 2016. The Company increased its sales volume from 3.91 million tonnes in 2016 to 4.65 million tonnes in 2017. The average realized selling price increased from $16.44 per tonne in 2016 to $28.31 per tonne in 2017, which was mainly a result of improved market conditions as well as an improved product mix. The product mix for 2017 consisted of approximately 19% of premium semi-soft coking coal, 52% of standard semi-soft coking coal and 29% of thermal coal compared to approximately 7% of premium semi-soft coking coal, 64% of standard semi-soft coking coal and 29% of thermal coal in 2016.

The Company's production in 2017 was higher than 2016 as a result of ramping up production to meet the expected increase in sales, yielding 6.38 million tonnes for 2017 as compared to 3.38 million tonnes for 2016.

The Company's unit cost of sales of product sold remained similar to 2016 (2017: $22.77 per tonne; 2016: $22.26 per tonne).

Summary of Annual Financial Results

	Year ended December 31,			
$ in thousands, except per share information		**2017**		2016
Revenue (i),(ii)	**$**	**120,973**	$	58,450
Cost of sales (ii)		**(105,858)**		(87,045)
Gross profit/(loss) excluding idled mine asset costs		**27,747**		(16,490)
Gross profit/(loss) including idled mine asset costs		**15,115**		(28,595)
Other operating expenses		**(11,264)**		(50)
Administration expenses		**(9,181)**		(7,888)
Evaluation and exploration expenses		**(273)**		(422)
Impairment of property, plant and equipment		**(11,171)**		(1,152)
Loss from operations		**(16,774)**		(38,107)
Finance costs		**(22,958)**		(22,314)
Finance income		**164**		239
Share of earnings of a joint venture		**1,287**		806
Income tax expense		**(1,740)**		(1,470)
Net loss		**(40,021)**		(60,846)
Basic and diluted loss per share	**$**	**(0.15)**	$	(0.24)

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

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

3. Overview of Operational Data and Financial Results continued

Overview of Annual Financial Results

The Company recorded a $16.8 million loss from operations in 2017 compared to a $38.1 million loss from operations in 2016. As a result of improved market conditions and prices for coal in China, the overall financial results improved when compared to 2016, which were principally attributable to increased coal sales as well as higher average selling price achieved during the year.

Revenue was $121.0 million in 2017 compared to $58.5 million in 2016. The Company's revenue is presented after deduction of royalties and selling fees. The Company's effective royalty rate for 2017, based on the Company's average realized selling price of $28.31 per tonne, was 5.8% or $1.65 per tonne compared to 7.0% or $1.14 per tonne based on the average realized selling price of $16.44 per tonne in 2016.

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 with the royalty regime. From February 1, 2016 onwards, royalties are to be 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 costs 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. See "*Risk Factors – Company's Projects in Mongolia*".

Cost of sales was $105.9 million in 2017 compared to $87.0 million in 2016. The increase in cost of sales in 2017 was mainly due to the increased sales during the year. Cost of sales comprises operating expenses, share-based compensation expense, equipment depreciation, depletion of mineral properties, coal stockpile inventory impairments and idled mine asset costs. Operating expenses in cost of sales reflect the total cash costs of product sold (a Non-IFRS financial measure, see Section 4 of this MD&A for further analysis) during the year.

$ in thousands	Year ended December 31, **2017**	2016
Operating expenses	**$ 55,451**	$ 41,452
Share-based compensation expense/(recovery)	**30**	(8)
Depreciation and depletion	**20,719**	26,142
Impairment of coal stockpile inventories	**17,026**	7,354
Cost of sales from mine operations	**93,226**	74,940
Cost of sales related to idled mine assets	**12,632**	12,105
Cost of sales	**$ 105,858**	$ 87,045

3. Overview of Operational Data and Financial Results continued

Overview of Annual Financial Results continued

Operating expenses in cost of sales were $55.5 million in 2017 compared to $41.5 million in 2016. The overall increase in operating expenses was primarily due to the increased sales volume from 3.91 million tonnes in 2016 to 4.65 million tonnes in 2017.

Cost of sales in 2017 and 2016 included coal stockpile impairments of $17.0 million and $7.4 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 years primarily related to the Company's higher-ash content products.

Cost of sales related to idled mine asset costs primarily consisted of periodic costs, which were expensed as incurred and included mainly depreciation expense. Cost of sales related to idled mine assets in 2017 included $12.6 million related to depreciation expenses for idled equipment (2016: $12.1 million).

Other operating expenses was $11.3 million in 2017 (2016: negligible).

$ in thousands		Year ended December 31, 2017		2016
Mining services, net	**$**	**(2,395)**	$	(1,006)
Provision of commercial arbitration		**(2,384)**		–
Impairment of properties for resale		**(1,718)**		–
Impairment of prepaid expenses and deposits		**(2,517)**		–
Underprovision of miscellaneous taxes		**(1,421)**		–
Foreign exchange gain/(loss)		**(1,116)**		5,423
Reversal of provision/(provision) for doubtful trade and other receivables		**682**		(2,641)
Discount on settlement of trade payables		**–**		1,009
Settlement of civil claims		**–**		(2,652)
Other		**(395)**		(183)
Other operating expenses	**$**	**(11,264)**	$	(50)

Mining services at the Tavan Tolgoi deposit were provided by the Company to Erdenes Tavan Tolgoi JSC ("Erdenes") in connection with settlement of the Tax Penalty (as hereinafter defined) at a net cost of $2.4 million in 2017 (direct mining costs and depreciation totaling $8.0 million, net of service revenue of $5.6 million) (2016: net cost of $1.0 million (direct mining costs and depreciation totaling of $3.1 million, net of service revenue of $2.1 million) (see Section 7 of this MD&A under the heading entitled "*Regulatory Issues and Contingencies – Governmental and Regulatory Investigations*" for more details).

In connection with the Arbitration Award involving First Concept, the Company recorded a provision for this commercial arbitration in the amount of $2.4 million in 2017.

An impairment of $1.7 million was recorded for certain properties for resale by the Company that were obtained by the Company pursuant to a settlement agreement with one of its major customers in connection with outstanding trade receivables, which reflects the drop in market value.

3. Overview of Operational Data and Financial Results continued

Overview of Annual Financial Results continued

Administration expenses were $9.2 million in 2017 as compared to $7.9 million in 2016, as follows:

	Year ended December 31,	
$ in thousands	**2017**	2016
Corporate administration	**$ 2,534**	$ 2,724
Professional fees	**2,464**	2,022
Salaries and benefits	**3,726**	2,820
Share-based compensation expense	**89**	58
Depreciation	**368**	264
Administration expenses	**$ 9,181**	$ 7,888

The increase in salaries and benefits was mainly due to the increase of headcount during the year, which is to support the expansion of the sales channel in China.

Evaluation and exploration expenses were $0.3 million in 2017 as compared to $0.4 million in 2016. The Company continued to minimize evaluation and exploration expenditures in 2017 in order to preserve the Company's financial resources. Evaluation and exploration activities and expenditures in 2017 were limited to ensuring that the Company met the Mongolian Minerals Law requirements in respect of its mining licenses.

A specific impairment charge of $11.2 million was made for the year ended December 31, 2017 on the deposits related to pending purchases of property, plant and equipment (2016: $1.2 million).

Finance costs were $23.0 million and $22.3 million in 2017 and 2016 respectively, which primarily consisted of interest expense on the $250.0 million CIC Convertible Debenture.

Finance income remained at $0.2 million for both 2017 and 2016, which primarily related to unrealized gains on the change in fair value of the embedded derivatives in the CIC Convertible Debenture ($0.1 million and $0.2 million for 2017 and 2016, respectively). The fair value of the embedded derivatives in the CIC Convertible Debenture is driven by many factors, including the Company's common share price, the USD and Canadian dollar exchange rate, and share price volatility.

3. Overview of Operational Data and Financial Results continued

Summary of Quarterly Operational Data

	2017				2016			
Quarter Ended	**31-Dec**	**30-Sep**	**30-Jun**	**31-Mar**	31-Dec	30-Sep	30-Jun	31-Mar
Sales Volumes, Prices and Costs								
Premium semi-soft coking coal								
Coal sales *(millions of tonnes)*	**0.37**	**0.12**	**0.18**	**0.19**	0.15	0.07	–	0.06
Average realized selling price *(per tonne)* (i)	**$ 50.47**	**$ 46.55**	**$ 45.67**	**$ 45.61**	$ 40.49	$ 21.04	$ –	$ 21.38
Standard semi-soft coking coal								
Coal sales *(millions of tonnes)*	**0.60**	**0.41**	**0.79**	**0.64**	0.65	0.77	0.52	0.58
Average realized selling price *(per tonne)* (i)	**$ 37.49**	**$ 28.32**	**$ 26.69**	**$ 23.36**	$ 16.79	$ 15.66	$ 16.27	$ 18.42
Thermal coal								
Coal sales *(millions of tonnes)*	**0.29**	**0.27**	**0.51**	**0.28**	0.28	0.29	0.30	0.24
Average realized selling price *(per tonne)* (i)	**$ 16.98**	**$ 14.48**	**$ 15.79**	**$ 13.17**	$ 15.26	$ 14.79	$ 9.17	$ 9.19
Total								
Coal sales *(millions of tonnes)*	**1.26**	**0.80**	**1.48**	**1.11**	1.08	1.13	0.82	0.88
Average realized selling price *(per tonne)* (i)	**$ 36.54**	**$ 26.41**	**$ 25.24**	**$ 24.52**	$ 19.55	$ 15.79	$ 13.65	$ 16.11
Raw coal production *(millions of tonnes)*	**0.51**	**2.47**	**1.89**	**1.51**	1.21	1.13	0.67	0.37
Cost of sales of product sold *(per tonne)*	**$ 23.54**	**$ 31.31**	**$ 18.50**	**$ 21.40**	$ 21.15	$ 19.53	$ 28.01	$ 21.62
Direct cash costs of product sold *(per tonne)* (ii)	**$ 9.91**	**$ 10.98**	**$ 7.84**	**$ 9.42**	$ 7.97	$ 7.13	$ 12.47	$ 7.88
Mine administration cash costs of product sold *(per tonne)* (ii)	**$ 4.92**	**$ 2.98**	**$ 2.22**	**$ 1.01**	$ 3.23	$ 2.26	$ 2.32	$ 1.24
Total cash costs of product sold (*per tonne)* (ii)	**$ 14.83**	**$ 13.96**	**$ 10.06**	**$ 10.43**	$ 11.20	$ 9.39	$ 14.79	$ 9.12
Other Operational Data								
Production waste material moved *(millions of bank cubic meters)*	**4.36**	**6.77**	**6.36**	**3.30**	2.62	2.22	1.82	0.72
Strip ratio *(bank cubic meters of waste material per tonne of coal produced)*	**8.59**	**2.74**	**3.37**	**2.18**	2.16	1.96	2.71	1.94
Lost time injury frequency rate (iii)	**0.03**	**0.04**	**0.04**	**0.02**	0.00	0.00	0.00	0.00

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

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

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

Overview of Quarterly Operational Data

For the fourth quarter of 2017, the Company had a lost time injury frequency rate of 0.03 per 200,000 man hours based on a rolling 12 month average.

As a result of improved market conditions and prices for coal in China, the Company experienced an increase in the average selling price of coal as compared to the fourth quarter of 2016. The Company increased its sales volume from 1.08 million tonnes in the fourth quarter of 2016 to 1.26 million tonnes in the fourth quarter of 2017. The average realized selling price increased from $19.55 per tonne in the fourth quarter 2016 to $36.54 per tonne in the fourth quarter of 2017, which was mainly a result of improved market conditions as well as an improved product mix.

3. Overview of Operational Data and Financial Results continued

Summary of Quarterly Financial Results

The Company's financial statements are reported under IFRS issued by the IASB. The following table provides 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	2017				2016			
Quarter Ended	**31-Dec**	**30-Sep**	**30-Jun**	**31-Mar**	31-Dec	30-Sep	30-Jun	31-Mar
Financial Results								
Revenue [i], [ii]	**$ 41,698**	**$ 19,356**	**$ 34,665**	**$ 25,254**	$ 18,983	$ 16,379	$ 10,361	$ 12,727
Cost of sales [ii]	**(29,665)**	**(25,049)**	**(27,385)**	**(23,759)**	(22,842)	(22,018)	(23,105)	(19,080)
Gross profit/(loss) excluding idled mine asset costs	**15,682**	**(2,094)**	**9,445**	**4,714**	(2,353)	(3,162)	(9,926)	(1,049)
Gross profit/(loss) including idled mine asset costs	**12,033**	**(5,693)**	**7,280**	**1,495**	(3,859)	(5,639)	(12,744)	(6,353)
Other operating income/(expenses)	**(7,488)**	**3,477**	**(4,045)**	**(3,208)**	(3,782)	4,631	812	(1,711)
Administration expenses	**(2,111)**	**(2,451)**	**(2,234)**	**(2,385)**	(2,378)	(2,042)	(1,826)	(1,642)
Evaluation and exploration expenses	**(52)**	**(48)**	**(144)**	**(29)**	(222)	(101)	(52)	(47)
Impairment of property, plant and equipment	**(11,171)**	**–**	**–**	**–**	(1,152)	–	–	–
Profit/(loss) from operations	**(8,789)**	**(4,715)**	**857**	**(4,127)**	(11,393)	(3,151)	(13,810)	(9,753)
Finance costs	**(6,250)**	**(5,674)**	**(5,494)**	**(5,715)**	(5,645)	(6,358)	(5,377)	(5,497)
Finance income	**143**	**142**	**50**	**4**	472	5	324	1
Share of earnings of a joint venture	**368**	**265**	**388**	**266**	378	89	256	83
Income tax credit/(expense)	**781**	**238**	**(2,714)**	**(45)**	(1,294)	82	(23)	(235)
Net loss	**(13,747)**	**(9,744)**	**(6,913)**	**(9,617)**	(17,482)	(9,333)	(18,630)	(15,401)
Basic and diluted loss per share	**$ (0.05)**	**$ (0.04)**	**$ (0.03)**	**$ (0.04)**	$ (0.07)	$ (0.04)	$ (0.07)	$ (0.06)

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

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

Overview of Quarterly Financial Results

The Company recorded a $8.8 million loss from operations in the fourth quarter of 2017 compared to a $11.4 million loss from operations in the fourth quarter of 2016.

Revenue was $41.7 million in the fourth quarter of 2017 compared to $19.0 million in the fourth quarter of 2016. The Company sold 1.26 million tonnes of coal at an average realized selling price of $36.54 per tonne in the fourth quarter of 2017 compared to sales of 1.08 million tonnes at an average realized selling price of $19.55 per tonne in the fourth quarter of 2016. Revenue increased in the fourth quarter of 2017 compared to the fourth quarter of 2016 as a combined result of the higher sales volumes as well as the improved average selling price.

The Company's revenue is presented after deduction of royalties and selling fees. The Company's effective royalty rate for the fourth quarter of 2017, based on the Company's average realized selling price of $36.54 per tonne, was 5.9% or $2.15 per tonne while the Company's effective royalty rate was 7.0% or $1.36 per tonne based on the average realized selling price of $19.55 per tonne in the fourth quarter of 2016.

3. Overview of Operational Data and Financial Results continued

Overview of Quarterly Financial Results continued

Cost of sales was $29.7 million in the fourth quarter of 2017 compared to $22.8 million in the fourth quarter of 2016. Cost of sales comprises operating expenses, share-based compensation expense, equipment depreciation, depletion of mineral properties, coal stockpile inventory impairments and idled mine asset costs. Operating expenses in cost of sales reflect the total cash costs of product sold (a non-IFRS financial measure, see Section 4 of this MD&A for further analysis) during the period.

	Three months ended December 31,	
$ in thousands	**2017**	2016
Operating expenses	**$ 18,695**	$ 12,095
Share-based compensation recovery	**–**	(2)
Depreciation and depletion	**3,429**	9,127
Impairment of coal stockpile inventories	**3,892**	116
Cost of sales from mine operations	**26,016**	21,336
Cost of sales related to idled mine assets	**3,649**	1,506
Cost of sales	**$ 29,665**	$ 22,842

Operating expenses included in cost of sales were $18.7 million in the fourth quarter of 2017 as compared to $12.1 million in the fourth quarter of 2016. The overall increase in operating expenses was primarily the result of the increase in sales volume from 1.08 million tonnes in the fourth quarter of 2016 to 1.26 million tonnes in the fourth quarter of 2017.

Cost of sales in the fourth quarter of 2017 and the fourth quarter of 2016 included coal stockpile impairments of $3.9 million and $0.1 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 years primarily related to the Company's higher-ash content products.

Idled mine asset costs in the fourth quarter of 2017 included depreciation expense for idled mine equipment of $3.6 million (2016: $1.5 million).

Other operating expenses were $7.5 million in the fourth quarter of 2017 (2016: $3.8 million). In connection with the Arbitration Award involving First Concept, the Company recorded a provision for this commercial arbitration in the amount of $2.4 million in the fourth quarter of 2017.

	Three months ended December 31,	
$ in thousands	**2017**	2016
Provision of commercial arbitration	**$ (2,384)**	$ –
Underprovision of miscellaneous taxes	**(1,421)**	–
Foreign exchange gain/(loss)	**(1,139)**	2,281
Impairment of prepaid expenses and deposits	**(2,517)**	–
Impairment of properties for resale	**(643)**	–
Reversal of provision/(provision) for doubtful trade and other receivables	**629**	(2,639)
Mining services, net	**–**	(1,006)
Settlement of civil claims	**–**	(2,362)
Other	**(13)**	(56)
Other operating expenses	**$ (7,488)**	$ (3,782)

3. Overview of Operational Data and Financial Results continued

Overview of Quarterly Financial Results continued

Administration expenses were $2.1 million in the fourth quarter of 2017 as compared to $2.4 million in the fourth quarter of 2016. The increase in salaries and benefits was mainly due to the increase of headcount during the year, which is to support the expansion of the sales channel in China.

	Three months ended December 31,			
$ in thousands		**2017**		2016
Corporate administration	**$**	**579**	$	689
Professional fees		**505**		727
Salaries and benefits		**891**		787
Share-based compensation expense		**22**		26
Depreciation		**114**		149
Administration expenses	**$**	**2,111**	$	2,378

Evaluation and exploration expenses were $0.1 million in the fourth quarter of 2017 as compared to $0.2 million in the fourth quarter of 2016. The Company continued to minimize evaluation and exploration expenditures in order to preserve the Company's financial resources. Evaluation and exploration activities and expenditures in the fourth quarter of 2017 were limited to ensuring that the Company met the Mongolian Minerals Law requirements in respect of its mining licenses.

Finance costs were $6.3 million in the fourth quarter of 2017 compared to $5.6 million in the fourth quarter of 2016, which primarily consisted of interest expense on the CIC Convertible Debenture.

Finance income was $0.1 million in the fourth quarter of 2017 compared to $0.5 million in the fourth quarter of 2016, which primarily consisted of unrealized gains on the fair value change of the embedded derivatives in the CIC Convertible Debenture. The fair value of the embedded derivatives in the CIC Convertible Debenture is driven by many factors, including the Company's common share price, the USD and Canadian dollar exchange rates and share price volatility.

4. Non-IFRS Financial Measures

The Company has included the non-IFRS financial measure "cash costs" in this MD&A to supplement its consolidated financial statements, which have been prepared in accordance with IFRS. The data presented is intended to provide additional information and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with IFRS.

The Company believes that this measure, together with measures determined in accordance with IFRS, provides 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.

4. Non-IFRS Financial Measures continued

Cash Costs

The Company uses cash costs to describe its cash production and associated cash costs incurred in bringing the inventories to their present locations and conditions. Cash costs incorporate all production costs, which include direct and indirect costs of production, with the exception of idled mine asset costs and non-cash expenses which are excluded. Non-cash expenses include share-based compensation expense, impairments of coal stockpile inventories, depreciation and depletion of property, plant and equipment and 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 following table provides a reconciliation of the cash costs of product sold disclosed for the three months and year ended December 31, 2017 and December 31, 2016. The cash costs of product sold presented below may differ from cash costs of product produced depending on the timing of coal stockpile inventory turnover and impairments of coal stockpile inventories from prior periods.

$ in thousands, except per tonne information	**Three months ended December 31, 2017**	2016	**Year ended December 31, 2017**	2016
Cash costs				
Cost of sales determined in accordance with IFRS	**$ 29,665**	$ 12,072	**$ 105,858**	$ 87,045
Less non-cash expenses	**(7,321)**	(6,431)	**(36,900)**	(32,014)
Less non-cash idled mine asset costs	**(3,649)**	(3,861)	**(12,632)**	(12,105)
Total cash costs	**18,695**	1,780	**56,326**	42,926
Coal sales *(millions of tonnes)*	**1.26**	0.21	**4.65**	3.91
Total cash costs of product sold *(per tonne)*	**$ 14.83**	$ 8.34	**$ 12.12**	$ 10.98

$ in thousands, except per tonne information	**Three months ended December 31, 2017**	2016	**Year ended December 31, 2017**	2016
Cash costs				
Direct cash costs of product sold *(per tonne)*	**$ 9.91**	$ 6.56	**$ 9.32**	$ 8.66
Mine administration cash costs of product sold *(per tonne)*	**4.92**	1.78	**2.80**	2.32
Total cash costs of product sold *(per tonne)*	**$ 14.83**	$ 8.34	**$ 12.12**	$ 10.98

The cash cost of product sold per tonne was $12.12 for 2017, which has increased from $10.98 per tonne for 2016. The reason for the increase is primarily related to the higher strip ratio achieved in 2017 as a result of more production waste material being moved (strip ratio of 3.26 for 2017 as compared to 2.18 for 2016).

5. Properties

The Company currently holds six mining licenses in Mongolia. The mining licenses pertain to the Ovoot Tolgoi Mine (MV-012726), the Soumber Deposit (MV-016869, MV-020436 and MV-020451) and the Zag Suuj deposit (MV-020676 and MV-020675).

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 content 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 content 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 for 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

The term "resource" is utilized to quantify coal contained in seams occurring within specified limits of thickness and depth from surface considered by the Qualified Person to have reasonable prospects for eventual economic extraction. For a complete description of a resource, refer to "mineral resource" under the heading "DEFINITIONS AND OTHER INFORMATION – Glossary of Geological and Mining Terms" in the Company's Annual Information Form dated March 31, 2017. The resource estimates presented are on an in-place basis (i.e., without adjustment for mining losses or coal recovery). Minimum seam thickness and maximum parting thickness are considered and coal intervals not meeting these criteria are not included in the reported resources.

In accordance with NI 43-101, DMCL has made reference to the GSC Paper 88-21 during the classification, estimation and reporting of coal resources for the Ovoot Tolgoi deposit. The exercise of resource classification is initially made based on the Geology-Type of the coal deposits as defined in the GSC Paper 88-21. According to the level of confidence of coal resource existence and data density, the resources are further classified into three categories respectively: Measured, Indicated and Inferred. These were considered by the Qualified Person during the classification of the resources at the Ovoot Tolgoi deposit.

5. Properties continued

Operating Mines continued

Resources continued

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 2016, particularly those relating to ongoing changes in coal market conditions in China, geologic analysis, optimized mining strategy and processing strategy, the Company has updated its resource and reserve estimate for the Ovoot Tolgoi deposit as disclosed in the Ovoot Tolgoi Technical Report, a copy of which is available under the Company's profile on SEDAR at www.sedar.com.

The resource estimate presented in this MD&A is derived from the Ovoot Tolgoi Technical Report and is materially different from the previous estimate made in the technical report entitled "Coal Geology and Resources, Ovoot Tolgoi Deposit, Mongolia – SouthGobi Resources Ltd" dated May 6, 2016 prepared by Minarco-MineConsult (known as RungePincoMinarco as of the date of such report) (the "2016 Technical Report") due to the following factors:

- The Geology Type classification has been re-categorized from "Severe" to "Complex", which led to a different requirement of spatial distribution of geological data and thus resource categorization according to GSC 88-21. Resource categories have been re-classified accordingly and this has resulted in the re-designation of Measured Resources in the overall resource portfolio of SGS.
- In-pit (surface) resources have been more conservatively constrained to a depth of 300m from the ground surface, compared to a depth of 350m used in the 2016 Technical Report.
- Underground resources have been re-established, as resources and considered to be of a reasonable prospect for eventual economic extraction due to recovering coal market conditions in China and Company's long-term plan for a thermal power plant for a location near the mine site which is expected to generate substantial demand for thermal coal for electricity generation.
- A more conservative approach was adopted, compared to the last technical report in 2012 that contemplated potential economic extraction for the underground portion of the Ovoot Tolgoi deposit (the "2012 Technical Report"), such that only underground resources to a depth of 500m were considered to be of a reasonable prospect for eventual economic extraction.

Resources have been estimated for the Ovoot Tolgoi Deposit as of December 31, 2016, including Measured Resources of 201.9 million tonnes ("Mt"), Indicated Resources of 100.3 Mt and Inferred Resources of 89.0 Mt.

Resource categorization was completed on a Seam Group basis. The resource categorization also took into account the continuity and confidence in drill hole intersections along each section. The estimate of resources at the Ovoot Tolgoi deposit is summarized in the following table.

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

5. Properties continued

Operating Mines continued

Resources continued

Ovoot Tolgoi Deposit – Surface Resource Estimate				
			Resource (Mt)	
Coalfield	Seam Group	Measured	Indicated	Inferred
Sunrise Pit (depth <300m)	7	2.2	2.9	2.0
	6	3.4	4.8	4.2
	5U	39.6	20.5	22.6
	5L	18.2	4.1	1.0
	4	0.4	0.7	0.6
	subtotal	**63.8**	**33.0**	**30.4**
Sunset Pit (depth <300m)	11	0.1	-	-
	10	8.8	2.1	0.1
	9	17.8	3.4	0.2
	8	16.4	3.2	0.3
	5U	25.6	6.3	0.3
	5L	11.8	2.3	0.8
	subtotal	**80.5**	**17.3**	**1.7**
Grand Total		**144.3**	**50.3**	**32.1**

Totals may not add up due to rounding.

Ovoot Tolgoi Deposit – Underground Resource Estimate				
			Resource (Mt)	
Coalfield	Seam Group	Measured	Indicated	Inferred
Sunrise (depth 300m to 500m)	5U	2.0	4.9	13.1
	5L	6.0	12.0	25.0
	Total	**8.0**	**16.9**	**38.1**
Sunset (depth 300m to 500m)	10	3.0	1.9	-
	9	6.2	4.6	0.4
	8	6.9	3.8	2.2
	5U	27.9	14.9	3.4
	5L	5.6	7.9	12.8
	Total	**49.6**	**33.1**	**18.8**
Grand Total		**57.6**	**50.0**	**56.9**

Totals may not add up due to rounding.

5. Properties continued

Operating Mines continued

Resources continued

Resources have been estimated as of December 31, 2016 using the Minex™ models provided by SGS. The key assumptions used for the resource estimation are:

- Minimum coal thickness = 0.6m;
- Maximum coal parting = 0.3m;
- Surface resources were constrained to a depth of 300m, the same as the pit design used in the 2012 Technical Report;
- Volumes were converted to tonnages using laboratory relative density analytical results converted to an estimated in-situ basis;
- Resources were constrained to the mining lease held by SGS only;
- Resources were estimated on an in-situ basis (i.e. as an in-situ tonnage and not adjusted for mining recovery);
- Resources were depleted by mined out tonnage; and
- Resources were estimated based on the survey data made available as of December 20, 2016 for the Sunrise and Sunset coalfields.

The resource estimate for the Ovoot Tolgoi deposit was derived from the Ovoot Tolgoi Technical Report, which was prepared by DMCL on behalf of the Company. A copy of the Ovoot Tolgoi Technical Report was filed under the Company's profile on SEDAR at www.sedar.com on May 15, 2017.

Reserves

The Company previously reported 175.7 Mt of proven and probable reserves in respect of the Ovoot Tolgoi Deposit based on the 2012 Technical Report. Subsequently, the total resources estimated for the Ovoot Tolgoi Deposit in the 2016 Technical Report significantly decreased from the 2012 Technical Report principally due to the exclusion of previously estimated underground resources, which were assessed as not having a reasonable prospect for eventual economic extraction. In response to the declining coal prices and weak coal transaction conditions in China, the previously established underground resource at the Ovoot Tolgoi deposit was not considered to be reasonably economically viable in the 2016 Technical Report, significantly reducing the Company's reported resources, which, together with the reclassification of the Geology Type of the deposit from "Complex" to "Severe", eliminated the Company's mineable reserves that had previously been established for the Ovoot Tolgoi deposit.

In late 2016, the Company and DMCL engaged in a comprehensive review of all relevant information including technical data, mining strategy, pit optimization, mine design, production scheduling, coal processing strategy, sales strategy, coal prices and recovering coal transaction conditions, in order to prepare and update its resources and reserve estimates and prepare a new mine plan. This process resulted in re-estimation of reserves by DMCL which appears in the table below.

5. Properties continued

Operating Mines continued

Reserves continued

The reserve estimate presented below is derived from the Ovoot Tolgoi Technical Report and is materially different from the previous estimate made in the 2016 Technical Report due to the following factors:

- The Geology Type classification has been re-categorized from "Severe" to "Complex", which led to a different requirement of spatial distribution of geological data and thus resource categorization according to GSC 88-21. Resource categories were re-classified accordingly such that portions of the Indicated and Inferred Resources were reclassified as Measured and Indicated Resources respectively. Such resource reclassification further resulted in the fact that the overall resource estimation and classification could be used in mine planning in conformity with the industry practice and NI 43-101 requirements; and
- In-pit (surface) resources are more conservatively constrained to a depth of 300m from the ground surface, compared to a depth of 350m used in the 2016 Technical Report.

Ovoot Tolgoi Deposit – Reserve Estimate				
			Reserve (Mt)	
Pit	Seam Group	Proven	Probable	Total
Sunrise Pit	7	0.4	0.5	0.9
	6	1.7	1.4	3.1
	5U	29.3	6.3	35.6
	5L	12.4	1.7	14.1
	4	0.4	0.5	0.9
	Subtotal	**44.3**	**10.3**	**54.6**
Sunset Pit	11	0.1	-	0.1
	10	5.0	0.6	5.6
	9	10.2	0.5	10.7
	8	10.4	0.5	10.9
	5U	21.1	1.8	22.9
	5L	8.6	0.9	9.5
	Subtotal	**55.2**	**4.3**	**59.5**
Grand Total		**99.5**	**14.6**	**114.1**

Totals may not add up due to rounding.

The above estimate of Reserves at the Ovoot Tolgoi Deposit have been estimated as of December 31, 2016 based on the resource model provided by SGS. Measured and Indicated Resources are inclusive of those Mineral Resources modified to produce the Reserves (i.e. Reserves are not additional to Resources).

5. Properties continued

Operating Mines continued

Reserves continued

The key assumptions used for the reserve estimation are:

- The reserve estimation used coal selling prices provided by an independent market consulting firm which was commissioned by the Company in December 2016 and subsequently confirmed as reasonable and appropriate by the qualified person responsible for this reserve estimate;
- Reserves do not include any Inferred Resources which have been treated as waste (i.e. the mining costs have been covered but no revenue has been assumed for the Inferred Resources);
- A recovery factor of 95% and a dilution factor of 2.5% have been applied in the Reserve estimate;
- The pit design (and thus Reserves) was designed to a depth of 300m below the original ground surface, which is same as the pit design used in the 2012 Technical Report;
- Reserves are constrained to the mining lease held by SGS only although the open pit limits will extend across the lease boundary into the adjacent lease held by Mongolyn Alt Corporation ("MAK"). SGS and MAK have an agreement in place that allows SGS to strip off the overburden in MAK's lease. Coal within the MAK pit and within the MAK's lease has been treated as generating no revenue and having no associated cost whereas the waste within the pits and MAK's lease will be stripped off at SGS' cost; and
- Reserves are estimated to account for coal and waste that was mined as of December 31, 2016.

The reserve estimate for the Ovoot Tolgoi deposit was derived from the Ovoot Tolgoi Technical Report, which was prepared by DMCL on behalf of the Company. A copy of the Ovoot Tolgoi Technical Report was filed under the Company's profile on SEDAR at www.sedar.com on May 15, 2017.

Mining Operations

Mining Method

The mining method employed at the Ovoot Tolgoi deposit could be described as open pit terrace mining utilizing large scale hydraulic excavators and shovels and trucks. Terrace mining is utilized where coal seams dip steeply and operating machinery on the coal seam roof and floor is not possible, due to the steep seam dips. Terraces, or benches, are excavated along fixed horizontal horizons and these benches intersect both coal and waste. Coal and waste are mined separately on each bench with dozers being used, as needed, to push coal or waste down to the excavator for loading onto trucks. This mining method allows large scale open pit mining to occur productively in steeply dipping coal seam environments. All waste is dumped ex-pit, as the steep dips preclude in-pit dumping.

The open pit limits extend across the Ovoot Tolgoi Mining License boundary into the adjacent lease held by MAK. As described previously, the Company and MAK have a cooperation agreement in place to allow mining across the boundary, which stipulates that SGS is responsible for removal of MAK waste but MAK is responsible for mining of MAK coal. Accordingly, the current reserve estimate does not include any coal within the MAK lease that must be extracted as part of the Company mining operation. Therefore in the current mine plan, no revenue has been assumed for the MAK coal whereas costs have been assumed for stripping off the MAK waste.

5. Properties continued

Mining Operations continued

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 SGS (together referred to as "RDCC LLC"). The Company has an indirect 40% interest 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. The Paved Highway has significantly increased the safety of coal transportation, reduced environmental impacts and improved efficiency and capacity of coal transportation. The toll rate was set at MNT 900 per tonne of coal (subsequently increased) as compared to MNT 1,500 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.

On February 4, 2017, the Board of RDCC LLC increased the toll rate from MNT 900 per tonne of coal to MNT 1,200, effective from March 1, 2017.

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

For the three months ended and the year ended December 31, 2017, RDCC LLC recognized toll fee revenue of $1.8 million (2016: $1.7 million) and $6.1 million (2016: $5.0 million), respectively.

Mining Equipment

The key elements of the currently commissioned mining fleet includes: two Liebherr 996 ($33m^3$ & $36m^3$) hydraulic excavators, three Liebherr R9250 ($15m^3$) hydraulic excavators and 23 MT4400AC (218 tonne capacity) haul trucks, together with various pieces of ancillary equipment.

Workforce

As at December 31, 2017, SGS employed 432 employees in Mongolia. Of the 432 employees, 46 are employed in the Ulaanbaatar office, 1 in an outlying office and 385 at the Ovoot Tolgoi Mine site. Of the 432 employees based in Mongolia, 397 (92%) are Mongolian nationals and of those, 210 (49%) are residents of the local Gurvantes, Dalanzadgad, Sevrei and Noyon Soums.

5. Properties continued

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 (collectively, the "Soumber Deposit"). 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 independent resource estimate prepared by RPM in accordance with NI 43-101. 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 Soumber Technical Report, a copy of which is available under the Company's profile 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 held 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 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 7 of this MD&A under the heading entitled "Regulatory Issues and Contingencies" for details of the status of the Soumber Deposit in respect of this designation 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 having regard to ongoing market conditions, government requirements and the Company's available financial resources.

5. Properties continued

Development Projects and Exploration Program continued

Zag Suuj Deposit

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

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 five, indicating metallurgical properties; however, limited metallurgical testing has been undertaken to date.

On March 25, 2013, the Company reported an updated independent resource estimate for the Zag Suuj Deposit prepared by RPM in accordance with NI 43-101. 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 300metres ("m") 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 Zag Suuj Technical Report, a copy of which is available under the Company's profile 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 two exploration licenses pertaining to the Zag Suuj Deposit (13779X and 5267X) for which PMAs were issued on August 14, 2013 were converted to mining licenses (MV-020676 and MV-020675) by the MRAM in November 2016.

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 were planned for the Zag Suuj Deposit in 2017. Exploration activities in 2018 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. As a result of the work performed by DMCL, resources have been re-installed in respect of the Ovoot Tolgoi Underground Deposit and are now considered to have reasonable prospect for eventual economic extraction due to recovering coal market conditions in China and Company's long-term plan of fire-power plant near to the mine site which will require a substantial supply of thermal coal nearby.

Exploration Program

The Company continued to minimize evaluation and exploration expenditures during 2017 in order to preserve the Company's financial resources. The 2018 exploration program will be limited to ensuring that the Company meets the Mongolian Minerals Law requirements in respect of its mining licenses including those related to the Soumber Deposit.

6. Liquidity and Capital Resources

Liquidity and Capital Management

The Company has in place a planning, budgeting and forecasting process to help determine the funds required to support the Company's normal operations on an ongoing basis and its expansionary plans.

Turquoise Hill Loan Facility

On May 25, 2014, the Company announced it 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 (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 as described below); 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 to 2016, the due date of the TRQ Loan, was extended several times and the maximum amount of the facility was reduced to $3.8 million.

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

- The Company agreed to effect monthly repayments on the last business day of each month in an amount of (i) $0.15 million per month from May 2016 to April 2017; (ii) $0.2 million per month from May 2017 to December 2017; and (iii) the remaining balance on December 29, 2017 (the payments in (i) and (iii), the "Repayments"); and
- Interest shall continue to accrue on all outstanding obligations at the 12-month US dollar LIBOR rate.

As of the date hereof, the Company has not paid its September, October, November and December 2017 monthly payments and the accrued interest. Pursuant to the terms of the TRQ Loan and the May 2016 Deferral Agreement, the Company is, as of the date of this MD&A, in default of its obligations under the TRQ Loan and the May 2016 Deferral Agreement as a result of the Company failing to make the Repayments in its entirety on or before the dates set out above. Consequently, all of the outstanding obligations under the TRQ Loan and the May 2016 Deferral Agreement are immediately due and payable to Turquoise Hill as of the date hereof. As of the date of this MD&A, the Company has received no indication from Turquoise Hill of any intention to demand payment of the amounts outstanding under the TRQ Loan and the May 2016 Deferral Agreement.

As at December 31, 2017, the outstanding principal and accrued interest under this facility amounted to $1.0 million and $0.7 million, respectively (at December 31, 2016, the outstanding principal and accrued interest under this facility amounted to $2.2 million and $0.7 million, respectively).

6. Liquidity and Capital Resources continued

Liquidity and Capital Management continued

Equipment Loan

Inner Mongolia SouthGobi Energy Ltd., a subsidiary of the Company, executed a $10.4 million loan agreement on August 31, 2017 with Beijing Jin Rui Tian Chen Asset Management Co Ltd. for the purpose of financing the purchase of mining equipment to increase the production capacity of the Company.

The key terms of the equipment loan are as follows:

- Principal amount of $10.4 million;
- Maturity date set at 12 months from each drawdown;
- Interest rate of 12% per annum and payable upon maturity; and
- The Company was to have provided a corporate guarantee to cover the principal and interest owed and certain items of property, plant and equipment were to have been pledged as security upon the completion of equipment purchase.

As at December 31, 2017, the outstanding principal and accrued interest for the equipment loan amounted to $2.3 million and $0.1 million, respectively (December 31, 2016: nil).

A loan arrangement fee of 1% of the loan principal drawn was charged and will be amortized throughout the loan term. For the year ended December 31, 2017, $8,000 of loan arrangement fee was amortized (2016: nil). The Company believes the principal amount is capped at the amount drawn down to date and the related mining equipment has not been purchased as of the date of the MD&A.

Bank Loan

On May 6, 2016, SGS obtained a bank loan (the "Bank Loan") in the principal amount of $2.0 million from a Mongolian bank (the "Bank"). The principal terms of the Bank Loan include, among other things, an interest rate of 15.8% per annum, a maturity date of May 6, 2017 (subsequently extended as described below) and SGS being required to pledge certain of its mobile equipment in favour of the Bank as collateral for the Bank Loan.

On July 6, 2017, the Company and the Bank entered into a supplementary agreement with the key commercial terms of the Bank Loan modified as follows:

- Principal amount increased to $3.0 million;
- $2.3 million of the principal amount will mature on May 6, 2018 while the remaining balance of the principal amount of $0.7 million will mature on January 4, 2019;
- Interest rate of 15.8% per annum applies to the $2.3 million portion of the principal amount, while an interest rate of 15.0% per annum applies to the remaining $0.7 million portion of the principal amount; in each case, interest is payable monthly; and
- Certain items of property, plant and equipment with value of $4.5 million as at December 31, 2017 were pledged as security.

As at December 31, 2017, the outstanding balance for the Bank Loan was $3.0 million (December 31, 2016: $2.0 million) and the Company owed accrued interest of $0.1 million (December 31, 2016: $0.1 million).

6. Liquidity and Capital Resources continued

Liquidity and Capital Management continued

Short-term bridge loan

On October 27, 2015, the Company executed a $10.0 million bridge loan agreement with an independent Asian based private equity fund. The bridge loan accrues interest at a rate of 8% per annum with interest payable upon the repayment of loan principal.

The Company repaid the first tranche of the short-term bridge loan with interest of $5.0 million up to August 11, 2016. During June and July 2016, the Company drew the second tranche of $5.0 million, of which $1.5 million was to mature in March 2017 and $3.5 million was to mature in April 2017. In December 2016, $1.5 million was repaid for the short-term bridge loan and a further $1.8 million and $1.6 million was subsequently repaid in January 2017 and March 2017, respectively and the loan principal was fully settled. The outstanding interest was settled in April 2017.

A loan arrangement fee of 5% of the loan principal drawn was charged, totaling $0.3 million for the loans drawn during June and July 2016 and amortized throughout the loan term. For the year ended December 31, 2017, $0.1 million of loan arrangement fee was amortized (2016: $0.2 million).

Costs reimbursable to Turquoise Hill

Prior to the completion of the private placement with Novel Sunrise on April 23, 2015, Rio Tinto plc ("Rio Tinto") was the Company's ultimate parent company. In the past, Rio Tinto sought reimbursement from the Company for the salaries and benefits of certain Rio Tinto employees who were assigned by Rio Tinto to work for the Company, as well as certain legal and professional fees incurred by Rio Tinto in relation to the Company's prior internal investigation and Rio Tinto's participation in the tripartite committee. Subsequently Rio Tinto transferred and assigned to Turquoise Hill its right to seek reimbursement for these costs and fees from the Company.

As at December 31, 2017, the amount of reimbursable costs and fees claimed by Turquoise Hill (the "TRQ Reimbursable Amount") amounted to $8.1 million (such amount is included in the aging profile of trade and other payables set out below). On October 12, 2016, the Company received a letter from Turquoise Hill, which proposed an arrangement for regular payments of the outstanding TRQ Reimbursable Amount. The Company has been in negotiations with Turquoise Hill regarding the proper quantum of the TRQ Reimbursable Amount and the terms for repayment. There can be no assurance, however, that any such terms can be successfully negotiated by the Company either at all or on favorable terms.

Going concern considerations

The Company's consolidated financial statements have been prepared on a going concern basis which assumes that the Company will continue operating until at least December 31, 2018 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.

6. Liquidity and Capital Resources continued

Liquidity and Capital Management continued

Going concern considerations continued

Several adverse conditions and material uncertainties cast significant doubt upon the going concern assumption. The Company had a working capital deficiency (excess current liabilities over current assets) of $166.3 million as at December 31, 2017 compared to $59.4 million of working capital deficiency as at December 31, 2016. Included in the working capital deficiency at December 31, 2017 are significant obligations, which include obligation to pay CIC under the June 2017 Deferral Agreement in which the Company was required to pay $9.7 million of cash interest and associated costs on November 19, 2017. In addition, pursuant to the terms of CIC Convertible Debenture, the Company was required to pay $8.1 million of anniversary cash interest on November 19, 2017. The Company is in discussions with CIC for a deferral of the November 19th Payments; however, there can be no assurance that a favorable outcome will be reached. Accordingly the principal amount outstanding and all accrued and unpaid interest and other amounts owing under the CIC Convertible Debenture and the June 2017 Deferral Agreement would immediately become due and payable in the event that CIC provides notice to the Company.

Pursuant to the Arbitration Award, SGS has been ordered to repay the sum of $11.5 million to First Concept, together with accrued interest at a simple interest rate of 6% per annum from the date which the prepayment was made until the date of the Arbitration Award, and then at a simple interest rate of 8% per annum until full payment. On March 23, 2018, SGS received a notice from First Concept demanding payment of the full amount of the Arbitration Award, together with the accrued interest thereon, by no later than March 30, 2018, otherwise First Concept intends to commence enforcement proceedings against SGS in respect of the Arbitration Award. In the event that First Concept applies to enforce the Arbitration Award against SGS, the Company intends to defend itself against such enforcement proceedings through independent litigation counsel; however, due to the inherent uncertainties of litigation, it is not possible to predict whether the Company will be successful in defending itself against any such enforcement proceedings. If First Concept is successful in enforcing the Arbitration Award, the Company may not be able to re-pay the sum of $11.5 million and the associated interest. In such case, this will represent another event of default under the CIC Convertible Debenture and CIC would have another basis 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 and associated interest to First Concept could result in voluntary or involuntary proceedings involving the Company (including bankruptcy).

6. Liquidity and Capital Resources continued

Liquidity and Capital Management continued

Going concern considerations continued

Further, the trade and other payables of the Company continue to accumulate due to liquidity constraints. The aging profile of the trade and other payables has risen as compared to that as at December 31, 2016, as follows:

$ in thousands	As at December 31, 2017	2016
Less than 1 month	**$ 20,664**	$ 14,640
1 to 3 months	**16,132**	2,493
3 to 6 months	**8,825**	2,648
Over 6 months	**33,598**	23,847
Total trade and other payables	**$ 79,219**	$ 43,628

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 being filed against the Company. No such lawsuits or proceedings are pending as at March 28, 2018.

The Company also has other current liabilities, which require settlement in the short-term, including: the $1.7 million balance of the TRQ Loan; the principal amount of bank loan of $2.3 million and associated interest due in May 2018 and the principal amount of equipment loan of $2.3 million and associated interest due in August 2018.

In the fourth quarter of 2016, the Company initiated a plan to change the existing product mix to higher value and higher margin outputs by washing certain grades of coal in order to produce more premium semi-soft coking coal and to initiate more processing of the lower grades of coal in order to reduce the ash content and improve the selling price and margins on its thermal coal product. The construction of the wash plant was substantially completed in 2017, however commencement of washing has been delayed to the second quarter of 2018.

6. Liquidity and Capital Resources continued

Liquidity and Capital Management continued

Going concern considerations continued

The current mine plan incorporates the coal washing and processing systems and contemplates significantly higher volumes of production in order to complement the Company's new product mix and sales volume targets. Such plans will require a significant level of stripping activities over the next two years and certain capital expenditures to achieve the designed production outputs. Such expenditures and other working capital requirements will require the Company to seek additional financing in the form of finance leases, debt or equity.

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 December 31, 2018, then the Company is unlikely to have sufficient capital resources or cash flows from mining operations in order to satisfy its current ongoing obligations and future contractual commitments. 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.

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.

As of the date of this MD&A, the Company is in default under the CIC Convertible Debenture and the TRQ Loan. Pursuant to the terms of the CIC Convertible Debenture, CIC may, at its discretion, provide notice to the Company and declare all principal, interest and other amounts owing under the CIC Convertible Debenture immediately due and payable, and take steps to enforce payment thereof. Pursuant to the terms of the TRQ Loan, all of the outstanding obligations under the TRQ Loan are immediately due and payable to Turquoise Hill as of the date hereof. As of the date of this MD&A, the Company has received no indication from CIC of any intention to deliver a notice of default under the CIC Convertible Debenture or to accelerate the amounts outstanding under the CIC Convertible Debenture, or from Turquoise Hill of any intention to demand payment of the amounts outstanding under the TRQ Loan. In addition, SGS received a notice from First Concept demanding payment of the full amount of the Arbitration Award, together with the accrued interest thereon, by no later than March 30, 2018, otherwise First Concept intends to commence enforcement proceedings against SGS in respect of the Arbitration Award. If SGS fails to satisfy the Arbitration Award, First Concept intends to enforce the Arbitration Award against SGS and, if First Concept is successful in enforcing the Arbitration Award, the Company may not be able to re-pay the sum of $11.5 million and the associated interest. Furthermore, continuing delay in securing additional financing could ultimately result in an event of default of the Equipment 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 the lender of the Equipment Loan 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 December 31, 2017, the Company's gearing ratio was 0.02 (2016: 0.37), which was calculated based on the Company's long term liabilities to total assets. As at December 31, 2017 and December 31, 2016, the Company is not subject to any externally imposed capital requirements.

As at March 28, 2018, the Company had $7.1 million of cash.

6. Liquidity and Capital Resources continued

CIC Convertible Debenture

In November 2009, the Company entered into a financing agreement with a wholly owned subsidiary of 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 first ranking charge over the Company's assets and certain subsidiaries. The financing was used primarily to support the accelerated investment program in Mongolia and for working capital, repayment of debt, general and administrative expenses and other general corporate purposes.

On March 29, 2010, the Company exercised its right to call for the conversion of up to $250.0 million of the CIC Convertible Debenture into approximately 21.5 million shares at a conversion price of $11.64 (CAD$11.88). As at December 31, 2017, CIC owned, through its indirect wholly owned subsidiary, approximately 23.8% of the issued and outstanding Common Shares of the Company.

On June 12, 2017, the Company executed the June 2017 Deferral Agreement with CIC for a revised repayment schedule on the May 2017 Interest Payable. The key repayment terms of the June 2017 Deferral Agreement are: (i) the Company was required to repay on average $2.2 million of the cash interest and associated costs monthly during the period from May 2017 to October 2017; and (ii) the Company was required to repay $9.7 million of cash interest and associated costs on November 19, 2017. The Company will pay a deferral fee at a rate of 6.4% per annum in consideration for the deferral.

At any time before the May 2017 Interest Payable is fully repaid, the Company is required to consult with and obtain written consent from CIC prior to effecting a replacement or termination of either or both of its Chief Executive Officer and its Chief Financial Officer, otherwise this will constitute an event of default under the CIC Convertible Debenture, but CIC shall not withhold its consent if the Board proposes to replace either or both such officers with nominees selected by the Board, provided that the Board acted honestly and in good faith with a view to the best interests of the Company in the selection of the applicable replacements.

In addition, pursuant to the terms of the CIC Convertible Debenture, the Company was required to pay $8.1 million of anniversary cash interest to CIC on November 19, 2017. Pursuant to the Convertible Debenture, the Company was also obliged to issue $4.0 million worth of November 2017 PIK Interest shares to CIC on November 19, 2017.

As of the date of this MD&A, the Company: (i) has neither paid the November 19th Payments nor issued the November 2017 PIK Interest shares to CIC within the cure period provided for in the CIC Convertible Debenture; and (ii) has not agreed upon a repayment plan for such amounts with CIC. Consequently, the Company is in default under the CIC Convertible Debenture and the June 2017 Deferral Agreement. Pursuant to the terms of the CIC Convertible Debenture and the June 2017 Deferral Agreement, CIC may, at its discretion, provide notice to the Company and declare all principal, interest and other amounts owing under the CIC Convertible Debenture and the June 2017 Deferral Agreement immediately due and payable, and take steps to enforce payment thereof, which would have a material adverse effect on the business and operations of the Company and may negatively affect the price and volatility of the Common Shares and any investment in such shares could suffer a significant decline or total loss in value. As of the date of this MD&A, the Company has received no indication from CIC of any intention to deliver a notice of default under the CIC Convertible Debenture and the June 2017 Deferral Agreement or to accelerate the amounts outstanding under the CIC Convertible Debenture and the June 2017 Deferral Agreement.

6. Liquidity and Capital Resources continued

CIC Convertible Debenture continued

The Company is in discussions with CIC for a deferral of the November 19th Payments and the November 2017 PIK Interest; however, there can be no assurance that a favorable outcome will be reached. As part of these discussions, CIC has notified the Company that, as a condition to agreeing to any deferral, it requires that the mutual co-operating agreement (the "Co-Operation Agreement") dated November 19, 2009 between the Company and CIC be amended to revise the manner in which the amount of the service fee payable to CIC under the Co-Operation Agreement is calculated with retroactive effect; however, the Company has not entered into any formal agreement in respect of the Co-Operation Agreement as of the date hereof. In addition, CIC has advised the Company that it is undertaking a review of the financial and operational performance of the Company. To the knowledge of the Company, this review remains on-going as of the date of this MD&A.

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.

As a consequence of the Company not entering into a deferral agreement with CIC as at December 31, 2017, IAS 1 requires the Company to classify the entire balance of the CIC Convertible Debenture as a current liability as at December 31, 2017, notwithstanding the fact that CIC has not indicated any intention to deliver notice of default or accelerate the maturity of the debenture. The Company anticipates that both the debt host and the fair value of the embedded derivative will be classified as a non-current liability upon the execution of a deferral agreement, unless a future event of default occurs under the terms of the CIC Convertible Debenture.

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.

On January 10, 2018, the Company received a confidential partial award (final except as to costs) with respect to the commercial arbitration. Pursuant to the Arbitration Award, SGS has been ordered to repay the sum of $11.5 million (which SGS had received as a prepayment for the purchase of coal) to First Concept, together with accrued interest at a simple interest rate of 6% per annum from the date which the prepayment was made until the date of the Arbitration Award, and then at a simple interest rate of 8% per annum until full payment. The Arbitration Award is final, except as to costs which have been reserved for a future award. As at December 31, 2017, the Company has recorded a provision of $13.9 million for the commercial arbitration. (2016: nil, during which the $11.5 million in relation to First Concept was recorded in deferred revenue).

6. Liquidity and Capital Resources continued

Commercial Arbitration in Hong Kong continued

On March 23, 2018, SGS received a notice from First Concept demanding payment of the full amount of the Arbitration Award, together with the accrued interest thereon, by no later than March 30, 2018, otherwise First Concept intends to commence enforcement proceedings against SGS in respect of the Arbitration Award. The Company is currently considering and reviewing its options with respect to the Arbitration Award, including exploring ways to work with First Concept on payment arrangements that are practical to and are in best interests of both parties; however, there can be no assurance that a favorable outcome will be reached. In any event, if SGS fails to satisfy the Arbitration Award, First Concept may apply to enforce the Arbitration Award against SGS through judicial measures in courts of Mongolia or in other applicable jurisdiction(s). In the event that First Concept applies to enforce the Arbitration Award against SGS through judicial measures in courts of Mongolia or in other applicable jurisdiction(s), the Company intends to defend itself against such enforcement proceedings through independent litigation counsel retained by the Company for this purpose. However, due to the inherent uncertainties of litigation, it is not possible to predict whether the Company will be successful in defending itself against any such enforcement proceedings.

If First Concept is successful in enforcing the Arbitration Award against SGS, the Company may not be able to re-pay the sum of $11.5 million and the associated interest. In such case, this will represent another event of default under the CIC Convertible Debenture and CIC would have another basis 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 and associated interest to First Concept could result in voluntary or involuntary proceedings involving the Company (including bankruptcy).

Cash Flow Highlights

$ in thousands	Year ended December 31, 2017	2016
Cash generated from operating activities	**$ 25,731**	$ 2,761
Cash used in investing activities	**(18,686)**	(1,530)
Cash used in financing activities	**(1,661)**	(579)
Effect of foreign exchange rate changes on cash	**121**	(63)
Increase in cash for the year	**5,505**	589
Cash balance, beginning of year	**966**	377
Cash balance, end of year	**$ 6,471**	$ 966

Cash generated from Operating Activities

The Company generated $25.7 million of cash in operating activities in 2017 compared to $2.8 million in 2016. This is primarily due to the increase in coal sales and revenue generated during the year.

Cash used in Investing Activities

For 2017, the Company used $18.7 million of cash in investing activities compared to $1.5 million for 2016. In 2017, deferred stripping expenditures on property, plant and equipment totaled $16.4 million (2016: $2.8 million) and $2.0 million of dividend income was collected from RDCC LLC (2016: $1.3 million).

6. Liquidity and Capital Resources continued

Cash Flow Highlights continued

Cash used in Financing Activities

Cash used in financing activities was $1.7 million in 2017, which was principally attributable to the net repayment of interest bearing loans (2016: $0.6 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 December 31, 2017, the Company's operating and capital commitments were:

$ in thousands	Within 1 year	2-3 years	Over 3 years	Total
As at December 31, 2017				
Capital expenditure commitments	$ 4,363	$ –	$ –	$ 4,363
Operating expenditure commitments	3,422	622	2,350	6,394
Commitments	**$ 7,785**	**$ 622**	**$ 2,350**	**$ 10,757**

Pursuant to an Investment and Collaboration Agreement dated April 2, 2016, the Company contracted with a third party to construct and operate a wash plant at the Ovoot Tolgoi mine site. Under the terms of the agreement the other party is responsible for all capital costs related to the construction of the facility and to operate the facility during the initial term of the contract, which is until 10 million tonnes of coal is washed. Upon reaching 10 million tonnes of coal washed, the ownership of the wash plant will pass to the Company. Payment for the coal washing will be RMB25 per tonne covering a set amount per tonne for operating costs and a set amount per tonne as a reimbursement of the capital costs. As such, upon commencement of the operations of the wash plant, it is expected that the agreement will be accounted for as a finance lease. Management is currently in discussions with the third party contractor to renegotiate certain terms of the contract prior to the commencement of commissioning.

Ovoot Tolgoi Mine Impairment Analysis

The Company determined that an indicator of impairment existed for its Ovoot Tolgoi Mine cash generating unit as at December 31, 2017. The impairment indicator was the uncertainty of future coal prices in China.

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 and washing assumptions, operating cost and life of mine coal production assumptions as at December 31, 2017. The Company's Ovoot Tolgoi Mine cash generating unit carrying value was $86.9 million as at December 31, 2017.

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

- Coal resources and reserves as estimated by an independent third party engineering firm;
- Sales price estimates from an independent market consulting firm;
- Forecasted sales volumes in line with production levels as per the mine plan;
- Life-of-mine coal production, strip ratio, capital costs and operating costs;

6. Liquidity and Capital Resources continued

Ovoot Tolgoi Mine Impairment Analysis continued

- Coal processing to increase the grade and qualities of the thermal coal produced and sold; and
- A post-tax discount rate of 15.5% based on an analysis of the market, country and asset specific factors.

The impairment analysis did not result in the identification of an impairment loss or an impairment reversal and no charge or reversal was required as at December 31, 2017. The Company believes that the estimates and assumptions incorporated in the impairment analysis are reasonable; however, the estimates and assumptions are subject to significant uncertainties and judgments.

Financial Instruments

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

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

The fair value of the notes receivables is determined based on the corporate bond yield of the bonds issued by the group companies of the notes issuing company.

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

$ in thousands	As at December 31, 2017	2016
Financial assets		
Fair value through profit or loss		
Notes receivables	**$ 12,520**	$ –
Loans-and-receivables		
Cash	**6,471**	966
Trade and other receivables	**16,486**	19,434
Total financial assets	**$ 35,477**	$ 20,400

$ in thousands	As at December 31, 2017	2016
Financial liabilities		
Fair value through profit or loss		
Convertible debenture – embedded derivatives	**$ 402**	$ 540
Other-financial-liabilities		
Trade and other payables	**79,219**	43,628
Interest-bearing borrowings	**7,693**	8,879
Convertible debenture – debt host	**115,972**	117,050
Total financial liabilities	**$ 203,286**	$ 170,097

6. Liquidity and Capital Resources continued

Financial Instruments continued

The net loss in 2017 and 2016 included the following amounts of unrealized gain from the fair value adjustments to the embedded derivatives of the CIC Convertible Debenture which is classified as FVTPL:

$ in thousands	Three months ended December 31, **2017**	2016	Year ended December 31, **2017**	2016
Unrealized gain on embedded derivatives in CIC Convertible Debenture	**$ 140**	$ 458	**$ 137**	$ 217

7. Regulatory Issues and Contingencies

Governmental and Regulatory Investigations

In May 2016, the Resolution 258 was issued by the Government of Mongolia, which approved the Company's proposal to partially settle a prior written verdict of the Mongolian Second District Criminal Court which declared SGS to be financially liable as a "civil defendant" for a penalty (the "Tax Penalty") of MNT 35.3 billion (approximately $18.2 million on February 1, 2015) by way of certain cash payments in 2016 and 2017 and by the Company performing certain mining operations at the Tavan Tolgoi deposit on behalf of Erdenes.

In compliance with Resolution 258, in November 2016, the Company entered into an agreement with Erdenes under which the Company agreed to perform certain mining operations equivalent to MNT 20.3 billion (approximately $8.1 million) in the West Tsankhi section of the Tavan Tolgoi deposit during the period from November 2016 to February 2017. In February 2017, the Company completed mining operations at the Tavan Tolgoi deposit equivalent to MNT 20.3 billion (approximately $8.1 million) as set out in the agreement with Erdenes.

On January 10, 2018, SGS was informed by the Court Decision Implementation Agency of Capital City in Mongolia that the enforcement procedure in relation to the Tax Verdict has been terminated and no party shall have any right to make any further claims in connection with the Tax Verdict. As of the date hereof, SGS has fulfilled its obligations under the Tax Verdict.

The decrease from the initial $18.2 million owing as of February 1, 2015 is as a result of transfers from frozen bank accounts of $1.2 million, additional cash payments by the Company of $5.4 million, the provision of mining services at the Tavan Tolgoi deposit of $8.1 million and the foreign exchange adjustments.

Mongolia's Independent Authority Against Competition (the "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 under the section entitled "Governmental and Regulatory Investigations" above. The restrictions on the assets were reaffirmed in the Tax Verdict and formed part of the Tax Penalty payable by the Company.

Following the termination of enforcement procedures in relation to the Tax Verdict, the orders imposed by the IAAC were removed on January 10, 2018.

7. Regulatory Issues and Contingencies continued

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 directors, and its former auditors, Deloitte LLP, in the Ontario Court in relation to the Company's restatement of certain financial statements previously disclosed in the Company's public filings (the "Restatement").

To commence and proceed with the Class Action, the plaintiff was required to bring a preliminary leave motion and to certify the Class Action as a class proceeding (the "Leave Motion"). The Ontario Court rendered its decision on the Leave Motion on November 5, 2015 and dismissed the plaintiff's Leave Motion as against each of the former senior officers and 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.

However, the Ontario Court allowed the Class Action to proceed under Part XXIII.1 of the Ontario Securities Act, permitting the plaintiff to commence and proceed with an action against the Company in respect of alleged misrepresentations affecting trades in the secondary market for the Company's securities arising from the Restatement. The Company appealed this portion of the decision of the Ontario Court (the "Corporation Appeal").

The plaintiff appealed that part of the November 5, 2015 Ontario Court decision dismissing the action against former officers and directors of the Company (the "Individual's Appeal"). The Individual's Appeal was brought as of right to the Ontario Court of Appeal.

On September 18, 2017, the Ontario Court of Appeal dismissed the Corporation Appeal of the original Ontario lower court decision to permit the plaintiff to commence and proceed with the Class Action. Concurrently, the Ontario Court of Appeal allowed the Individual's Appeal of the original Ontario lower court decision to dismiss the plaintiff's leave motion against certain of the Company's former officers and directors and made an order granting leave for the plaintiff to proceed against such former officers and directors of the Company in relation to the Restatement. As a result, the plaintiff is now permitted to proceed with the Class Action against both the Company and the former officers and directors.

The Company filed an application for leave to appeal to the Supreme Court of Canada in November 2017. Leave to appeal is expected to be decided by May, 2018. If leave to appeal is granted, the appeal would likely be scheduled to be heard in early 2019.

The Company firmly believes that it has a strong defense on the merits and will continue to vigorously defend itself against the Class Action through independent Canadian litigation counsel retained by the Company 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 potential losses, if any. However, the Company has judged a provision for this matter as at December 31, 2017 was not required.

7. Regulatory Issues and Contingencies continued

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 had a duration of five years from commencement of the contract and provided 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. Accordingly, the Company has determined a provision for this matter at December 31, 2017 is not required.

Mining Prohibition in Specified Areas Law

In July 2009, Mongolia promulgated the Law on Prohibiting Mineral Exploration and Extraction Near Water Sources, Protected Areas and Forests (the "Mining Prohibition in Specified Areas Law"). Pursuant to the Mining Prohibition in Specified Areas Law, the Government of Mongolia has defined the boundaries of certain areas in which exploration and mining is purportedly prohibited. A list of licenses was prepared that overlap with the prohibited areas described in the law based on information submitted by water authority agencies, forest authority agencies and local authorities for submission to the Government of Mongolia.

In order to address the issues facing its implementation, in February 2015 the Parliament of Mongolia adopted an amendment to the Law on Implementation of the Mining Prohibition in Specified Areas Law (the "Amended Law on Implementation"). The Amended Law on Implementation provided an opportunity for license holders covered within the scope of application of the Mining Prohibition in Specified Areas Law to continue their mining operations subject to advance placement of funds to cover 100% of the future environmental rehabilitation costs. A model contract and a specific Government regulation on this requirement will be adopted by the Government. The license holders were required to apply within 3 months after the amendment to the Law on Implementation came into effect for permission to the Mineral Resources Authority of Mongolia to resume activities. The Company considered that its development projects may be affected, but not its operating mines. The Company submitted its application with respect to its mining licenses before the deadline set on June 16, 2015.

Pursuant to the Mongolian Law "To prohibit mineral exploration and mining operations at headwaters of rivers, water protection zones and forested areas", the Government administrative agency has notified the Company that special license area 12726A is partly overlapping with a water reservoir. The Company has inspected the area together with the Cadastral Division of the Mineral Resource Authority as well as through the cadastral registration system of the Ministry of Environment, and determined that 29 hectares of Sukhait Bulag was partly overlapping with a water reservoir, of which has been partly handed over. (Resolution No.6/7522 issued on September 29, 2015 by the Head of Cadastral Division of the Mineral Resource Authority).

7. Regulatory Issues and Contingencies continued

Mining Prohibition in Specified Areas Law continued

In accordance with Article 22.3 of Law of Mongolia on Water, 5,602.96 hectares of land, including Sukhaityn Bulag, Uvur Zadgai, and Zuun Shand pertaining to exploration license 9443X, which was converted to mining license MV-0125436 in January 2016, was overlapping with a protected area boundary. The overlapping area has been officially handed over to the local administration. (Resolution No.688 issued on September 24, 2015 by the Head of Cadastral Division of the Mineral Resource Authority). In connection with the nullification of Annex 2 of Government order No.194 "On determining boundary" issued on June 5, 2012, the area around the water reservoir located at MV-016869 license area and Soumber exploration license 9449X, which was converted to mining license MV-020451 in January 2016, was annulled from the Specified Area Law.

Therefore, mining licenses 12726A and MV-016869 and exploration licenses 9443X and 9449X were removed from the list of licenses that overlaps with the prohibited areas described in the law.

Areas specified in all 6 of the Company's mining licenses do not overlap with any areas provided in the "Law on prohibition of mineral exploration and mining operations at headwaters of rivers, water protection zones and forested areas" as referenced in No.194 Resolution dated 2012 and No.289 Resolution dated 2015 of the Government of Mongolia.

There has been limited development of the law since 2016, while two exploration licenses of the Company (13779X and 5267X) were converted to mining licenses (MV-020676 and MV-020675) in November 2016. The Company will continue to monitor the developments and ensure that it follows the necessary steps in the Amended Law on Implementation to secure its operations and licenses and is fully compliant with Mongolian law.

Special Needs Territory in Umnugobi

On February 13, 2015, the entire Soumber mining license and a portion of SGS' exploration license 9443X (9443X was converted to mining license MV-020436 in January 2016) (the "License Areas") were included into a special protected area (to be further referred as Special Needs Territory, the "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 CRKh election was held. As a result, the Company was aware that additional action may be taken in respect of the SNT; however, the Company has not yet received any indication on the timing of the next session of the CRKh.

7. Regulatory Issues and Contingencies continued

Settlement of Lawsuit Notice from a Former Fuel Supplier

On June 30, 2017, the Company signed the Triparty Settlement Agreement with MTLLC and ICIC pursuant to which: (i) MTLLC transferred to ICIC its right to receive payment from the Company of the Outstanding Amount and its right to enforce the arbitration award against the Company in connection therewith; and (ii) the Company and ICIC agreed to a revised payment schedule for repayment of the Outstanding Amount. Pursuant to the Triparty Settlement Agreement, the Company will pay interest on the Outstanding Amount, which shall accrue at a monthly rate of 1.8% and will be settled on a monthly basis. The Company was required to repay on average $1.3 million monthly during the period from July 2017 to November 2017 pursuant to the Triparty Settlement Agreement.

As of the date of this MD&A, the Company has fulfilled its obligations under the Triparty Settlement Agreement and has fully repaid the Outstanding Amount.

Mongolian royalties

During the year ended December 31, 2017, the Company has been ordered by the Mongolian tax authority to apply "reference price" determined by the Government of Mongolia as opposed to calculated sales price that derived based on the actual contract price. Although no official letter was received by the Company as of the date hereof, there can be no assurance that the Government of Mongolia will not disagree with the methodology employed by the Company in determining the calculated sales price and deem such price "non-market" under Mongolian tax law.

Management believes that its interpretation of the relevant legislation is appropriate and the Company's positions related to royalty will be sustained. As of December 31, 2017, recognition of a provision for addition Mongolian royalties is not necessary.

8. Environment

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

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

In addition to those duties imposed on them by the EPL, mining license holders are required to prepare an initial environmental impact assessment analysis before the mine comes into production. The mining license holders must also annually develop and implement an environmental management plan (including reclamation measures) in co-operation with the Ministry of Environment, Green Development and Tourism, which should take into account the results of the environmental impact assessment. The Company received approval of its detailed Environmental Impact Assessment and Environmental Management Plan from the Mongolian Ministry of Environment for the mining operation at the Ovoot Tolgoi Mine in 2007 and renewed in 2016.

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

The Company established an environmental policy in 2008. The environmental policy affirms the Company's commitment to environmental protection. The Company monitors its operations to ensure that it complies with all applicable environmental requirements, and takes actions to prevent and correct problems if needed. In accordance with new provisions specified in Mongolian laws and regulations, in 2014 the Company developed a protection strategy jointly with professional organization. This strategic plan can serve as a policy document directed to protection of biological diversity, ecosystem balance and its preservation; and support species dwelling nearby the Ovoot Tolgoi mine area.

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

9. Emolument Policy

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

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

The Company has also adopted an equity incentive plan to incentivize directors and eligible employees. Details of the plan are set out in note 28 of the Company's consolidated financial statements for the year ended December 31, 2017.

10. Outstanding Share Data

The Company is authorized to issue an unlimited number of Common Shares without par value and an unlimited number of preferred shares without par value. As at March 28, 2018, approximately 272.6 million Common Shares were issued and outstanding. There are also incentive share options outstanding to acquire approximately 2.3 million unissued Common Shares with exercise prices ranging from CAD$0.25 to CAD$1.92. There are no preferred shares outstanding.

As at March 28, 2018, CIC holds a total of approximately 64.8 million Common Shares representing approximately 23.8% of the issued and outstanding Common Shares.

As at March 28, 2018, Novel Sunrise holds a total of approximately 46.4 million Common Shares representing approximately 17.0% of the issued and outstanding Common Shares.

As at March 28, 2018, Voyage Wisdom Limited holds a total of approximately 25.8 million Common Shares representing approximately 9.5% of the issued and outstanding Common Shares.

11. Disclosure Controls and Procedures and Internal Controls Over Financial Reporting ("ICFR")

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

Management, including the Chief Executive Officer and Chief Financial Officer of the Company, has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures. As of December 31, 2017, the Chief Executive Officer and Chief Financial Officer of the Company have each concluded that the Company's disclosure controls and procedures, as defined in NI 52-109 – *Certification of Disclosure in Issuer's Annual and Interim Filings*, are effective to achieve the purpose for which they have been designed.

11. Disclosure Controls and Procedures and Internal Controls Over Financial Reporting ("ICFR") continued

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

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

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

Management assessed the effectiveness of internal controls over financial reporting using the Internal Control – Updated Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that the Company's internal controls over financial reporting were effective as of December 31, 2017.

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

12. Critical Accounting Estimates and Judgments

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

A detailed summary of all of the Company's significant accounting policies is included in note 3 to the Company's consolidated financial statements for the year ended December 31, 2017. Information about judgments and estimates in applying accounting policies that have the most significant effect on the amounts recognized in the consolidated financial statements are as follows:

12. Critical Accounting Estimates and Judgments continued

Liquidity and Going Concern Assumption

In the determination of the Company's ability to meet its ongoing obligations and future contractual commitments, 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.

As of the date hereof, the Company is in default under the CIC Convertible Debenture and the TRQ Loan. Pursuant to the terms of the CIC Convertible Debenture, CIC may, at its discretion, provide notice to the Company and declare all principal, interest and other amounts owing under the CIC Convertible Debenture immediately due and payable, and take steps to enforce payment thereof. Pursuant to the terms of the TRQ Loan, all of the outstanding obligations under the TRQ Loan are immediately due and payable to Turquoise Hill as of the date hereof. As of the date hereof, the Company has received no indication from CIC of any intention to deliver a notice of default under the CIC Convertible Debenture or to accelerate the amounts outstanding under the CIC Convertible Debenture, or from Turquoise Hill of any intention to demand payment of the amounts outstanding under the TRQ Loan.

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 Equipment 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 lender of the Equipment Loan and the lender of the Bank Loan, respectively.

Valuation of embedded derivatives

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

The key inputs used by the Company in its Monte Carlo simulation are further disclosed in Note 25.2 and Note 25.3 of the Company's consolidated financial statements for the year ended December 31, 2017. Changes in the inputs to the valuation model could impact the carrying value of the embedded derivatives in the convertible debenture and the amount of unrealized gains or losses recognized in profit or loss.

Review of Carrying Value of assets and impairment charges

In the determination of carrying values and impairment charges, management of the Company reviews the recoverable amount (the higher of the fair value less costs 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

See Section 6 "Liquidity and Capital Resources – Ovoot Tolgoi Mine Impairment Analysis" for further analysis of the impairment test performed as at December 31, 2017.

12. Critical Accounting Estimates and Judgments continued

Estimated Resources

The Company estimates its mineral resources based on information compiled by appropriately qualified persons relating to the geological data on the size, depth and shape of the ore body, and requires complex geological judgments to interpret the data. Changes in resource estimates may impact the carrying value of mining interests, mine restoration provisions, recognition of deferred tax assets, and depreciation and amortization charges.

Estimated Recoverable Reserves

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

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

Useful lives and depreciation rates for property, plant and equipment

Depreciation expense is allocated based on estimated property, plant and equipment useful lives and depreciation rates except the mineral properties are depreciated on unit-of production basis based on proven and probable reserves. Therefore, changes in the useful life or depreciation rates from the initial estimate could impact the carrying value of property, plant and equipment and an adjustment would be recognized in profit or loss.

13. Recent Accounting Pronouncements

The standards that are issued up to the date of issuance of the Company's financial statements, but were not effective during the year ended December 31, 2017, are disclosed below. The Company intends to adopt these standards, if applicable, when they become effective.

IFRS 9	Financial Instruments[i]
IFRS 15	Revenue from Contracts with Customers[i]
IFRS 16	Leases[ii]

(i) Effective for annual periods beginning on or after January 1, 2018

(ii) Effective for annual periods beginning on or after January 1, 2019

13. Recent Accounting Pronouncements continued

IFRS 9, Financial Instruments ("IFRS 9") – classification and measurement, addresses the classification, measurement and derecognition of financial assets and financial liabilities, introduces new rules for hedge accounting and a new impairment model for financial assets. The Company does not expect the new guidance to affect the classification and measurement of its financial assets and liabilities.

There will be no impact on the Company's accounting for financial liabilities. The derecognition rules have been transferred from IAS 39 Financial Instruments: Recognition and Measurement and have not been changed.

The new impairment model requires the recognition of impairment provisions based on expected credit losses rather than only incurred credit losses as is the case under IAS 39. It applies to financial assets classified at amortised cost.

The Company is currently evaluating the impacts that IFRS 9 will have on its financial statement.

IFRS 15, Revenue from Contracts with Customers ("IFRS 15"), deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Revenue is recognized when a customer obtains control of a good or service and thus has the ability to direct the use and obtain the benefits from the good or service. The standard replaces IAS 18 Revenue and IAS 11 Construction Contracts, and related interpretations. The standard is effective for annual periods beginning on or after January 1, 2018 and earlier application is permitted. At this time the Company does not expect IFRS 15 to have a significant effect on revenue recognition. The Company is continuing to investigate the disclosure requirement on the new standard.

IFRS 16, Leases ("IFRS 16"), on January 13, 2016 the IASB issued IFRS 16, according to which, all leases will be recognized on the balance sheet, as the distinction between operating and finance leases is removed. Under the new standard, an asset (the right to use the leased item) and a financial liability to pay rentals are recognized. The only exceptions are short-term and low-value leases.

The Company is currently evaluating the impacts that IFRS 16 will have on its financial statement.

There are no other IFRS or IFRIC interpretations with future effective dates that are expected to have a material impact on the Company.

14. Risk Factors

There are certain risks involved in the Company's operations, some of which are beyond its control. These risks can be broadly categorized into: (i) risks relating to the Company's ability to continue as a going concern; (ii) risks relating to the economic operation of the Company's Ovoot Tolgoi Mine; (iii) risks relating to the Company's other projects in Mongolia; and (iv) risks relating to its business and industry. The risk factors identified below could have a material adverse impact on the Company's business, operations, results of operations, financial condition and future prospects and could cause actual events to differ materially from those described in forward-looking statements relating to the Company. Additional risks and uncertainties not presently known, or not expressed or implied below, or that are presently deemed immaterial, could also harm the Company's business, operations, results of operations, financial condition and future prospects. Some of the following statements are forward-looking and actual results may differ materially from the results anticipated in these forward-looking statements. See "Forward-Looking Statements".

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

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

The Company's consolidated financial statements have been prepared on a going concern basis, which assumes that the Company will continue operating until at least December 31, 2018 and will be able to realize its assets and discharge its liabilities in the normal course of operations as they come due. However, certain adverse conditions and material uncertainties cast doubt upon the ability of the Company to continue as a going concern. These include:

- as of the date of this MD&A, the Company is in default under the CIC Convertible Debenture and the TRQ Loan. See Section 6 of this MD&A under the headings entitled "*Liquidity and Capital Resources – CIC Convertible Debenture*" and "*Liquidity and Capital Resources – Liquidity and Capital Management – Turquoise Hill Loan Facility*";

- pursuant to the Arbitration Award, SGS has been ordered to repay the sum of $11.5 million to First Concept, together with accrued interest at a simple interest rate of 6% per annum from the date which the prepayment was made until the date of the Arbitration Award, and then at a simple interest rate of 8% per annum until full payment. On March 23, 2018, SGS received a notice from First Concept demanding payment of the full amount of the Arbitration Award, together with the accrued interest thereon, by no later than March 30, 2018, otherwise First Concept intends to commence enforcement proceedings against SGS in respect of the Arbitration Award. See Section 6 of this MD&A under the heading entitled "Liquidity and Capital Resources - Commercial Arbitration in Hong Kong";

- the Company has a working capital deficiency (excess current liabilities over current assets) of $166.3 million as at December 31, 2017, including the November 19th Payments of $17.8 million;

- the trade and other payables of the Company continue to accumulate due to liquidity constraints. See the Company's aging profile of the trade and other payables as at December 31, 2017 in Section 6 of this MD&A under the heading entitled "*Liquidity and Capital Resources – Liquidity and Capital Management – Going Concern Considerations*"; and

- the Company has other current liabilities which require settlement in the short-term, including, the principal amount of bank loan of $2.3 million and associated interest due in May 2018, and the principal amount of equipment loan of $2.3 million and associated interest due in August 2018.

14. Risk Factors continued

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

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

The foregoing adverse conditions indicate there is uncertainty about the Company's ability to continue as a going concern. Absent additional sources of financing, a refinancing or a restructuring, the Company is unlikely to have sufficient capital resources or cash flows from mining operations in order to satisfy its current ongoing obligations and future contractual commitments.

With respect to the CIC Convertible Debenture, CIC may, at its discretion, provide notice to the Company and declare all principal, interest and other amounts owing under the CIC Convertible Debenture immediately due and payable, and take steps to enforce payment thereof, which would have a material adverse effect on the business and operations of the Company and may negatively affect the price and volatility of the Common Shares and any investment in such shares could suffer a significant decline or total loss in value.

With respect to the TRQ Loan, all of the outstanding obligations under the TRQ Loan are immediately due and payable to Turquoise Hill as of the date hereof. With respect to the Arbitration Award, SGS received a notice from First Concept demanding payment of the full amount of the Arbitration Award, together with the accrued interest thereon, by no later than March 30, 2018, otherwise First Concept intends to commence enforcement proceedings against SGS in respect of the Arbitration Award. If SGS fails to satisfy the Arbitration Award, First Concept intends to enforce the Arbitration Award against SGS and, if First Concept is successful in enforcing the Arbitration Award, the Company may not be able to re-pay the sum of $11.5 million and the associated interest. Furthermore, continuing delay in securing additional financing could ultimately result in an event of default of the Equipment 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 the lender of the Equipment Loan and the lender of the Bank Loan, respectively.

There are no assurances that additional capital can be obtained on favourable terms, if at all. There are also no assurances that a favorable outcome will be reached in connection with the Company's discussions with CIC for a deferral of the amounts outstanding under the CIC Convertible Debenture, or with respect to the TRQ Loan or Arbitration Award. In view of these conditions, the ability of the Company to continue as a going concern is dependent upon its ability to generate sufficient operating cash flows, secure additional capital or otherwise pursue a strategic restructuring, refinancing or other transactions to provide it with additional liquidity.

The Company anticipates the situation faced by the Company will remain challenging in 2018, which will continue to have an impact on the Company's margins and liquidity. The Company's plans to change the existing product mix to higher value and higher margin outputs is dependent on its ability to finance certain capital expenditures and maintain working capital requirements. The current mine plan incorporates the coal washing and processing systems and contemplates significantly highes volumes of production in order to complement the Company's new product mix and sales volume targets. Such plans will require a significant level of stripping activities over the next two years and certain capital expenditures to achieve the designed production outputs. Such expenditures and other working capital requirements will require the Company to seek additional financing in the form of finance lease, debt or equity. There are no assurances the Company will be able to execute the planned measures 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 December 31, 2018, then the Company is unlikely to have sufficient capital resources or cash flows from mining operations in order to satisfy its current ongoing obligations and future contractual commitments.

If the Company is unable to continue as a going concern, it would likely need to seek relief under applicable bankruptcy and insolvency legislation, which may negatively affect the price and volatility of the Common Shares and any investment in such shares could suffer a significant decline or total loss in value.

14. Risk Factors continued

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

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

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

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

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.

The Company is subject to litigation risks. In the normal course of the Company's business, it may come involved in, named as a party to, or be the subject of, various legal proceedings, including, without limitations, mining laws. environmental laws, labour laws, and anti-corruption and anti-bribery laws in the jurisdictions in which the Company operates. Defense and settlement costs associated with legal claims can be substantial, even with respect to claims that are frivolous or have no merit. Due to the inherent uncertainty of the litigation process, the resolution of any particular legal proceeding to which the Company is or may become subject could have a material adverse impact on its business, operations, results of operations, financial condition and future prospects.

The Company is currently a defendant in the Class Action (as more particularly described in Section 7 "*Regulatory Issues and Contingencies*" of this MD&A). The Company firmly believes that it has a strong defense on the merits and will continue to vigorously defend itself against the Class Action through independent Canadian litigation counsel retained by the Company 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 potential losses, if any.

In the event the Company incurs any liability in connection with the Class Action, it maintains insurance with respect thereto. While the Company believes that such insurance coverage is in an amount that would be sufficient to cover any amounts the Company may be required or determines to pay with respect thereto, there can be no assurance that such coverage will be adequate to do so, and, if so, any amounts not so covered would be required to be paid by the Company. The Company's ability to continue as a going concern will be impacted to the extent it is required to pay any amounts in connection with the Class Action, which would have a material adverse effect on the business and operations of the Company and may negatively affect the price and volatility of the Common Shares and any investment in such shares could suffer a significant decline or total loss in value.

14. Risk Factors continued

Risks Relating to the Economic Operation of the Company's Ovoot Tolgoi Project

There can be no assurance that the updated mine plan developed for the Ovoot Tolgoi Mine will ultimately be viable or profitable due to the inherent operational risks.

As a result of work performed by DMCL, the Company increased its estimate of total resources at the Ovoot Tolgoi deposit from those described in the 2016 Technical Report, has declared reserves for the Ovoot Tolgoi deposit and prepared a new mine plan. There are no assurances, however, that the Company will execute its mine plan and realize on the estimates for the Ovoot Tolgoi deposit. It is not unusual in the mining industry for mining operations to experience unexpected problems during commercial production, resulting in delays and requiring more capital than anticipated. Actual costs and economic returns may differ materially from the Company's estimates. Risks associated with the operation of mines include, but are not limited to, the following:

- Unusual or unexpected geological formations;
- Unstable ground conditions that could result in cave-ins or landslides;
- Floods;
- Power outages;
- Restrictions or interruptions in supply of key materials;
- Labour disruptions or shortages;
- Social unrest in adjacent areas;
- Equipment failure;
- Fires and explosions; and
- Inability to obtain suitable or adequate machinery, equipment, or labour.

In addition, risks particular to the Company's mine plan include:

- Transition to contract mining and if the Company is able to negotiate a contract with applicable contractors at rates that justify the transition;
- Ability to generate sufficient sales volumes at economical realized prices;
- Water supply to the mine site to permit full operation of a wet washing plant;
- Achieving satisfactory yields from wet washing operations;
- Successful conversion of resources into reserves during the life of mine; and
- With respect to the wet washing plant, construction of the wash plant was substantially completed in 2017, however commencement of washing has been delayed to the second quarter of 2018. There can be no assurance, however, that commencement of operations of the wash plant will not be further delayed, which would have a material adverse effect on the business and operations of the Company and may negatively affect the price and volatility of the Common Shares. The Company is also currently in discussions with the third party contractor to renegotiate certain terms of the Wash Plant Agreement prior to the commencement of commissioning of the wash plant; however, there can be no assurance that a favorable outcome will be reached.

Any of the risks noted above could have a material adverse impact on the Company's financial performance, cash flow and results of operations, which may negatively affect the price and volatility of the Common Shares and any investment in such shares could suffer a significant decline or total loss in value.

14. Risk Factors continued

Risks Relating to the Company's Projects in Mongolia

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

The Company is subject to certain investigations referred to under Section 7 of this MD&A under the heading entitled "*Regulatory Issues and Contingencies – Regulatory Issues – Governmental and Regulatory Issues*", which could result in one or more of the Mongolian, Canadian, United States or other governmental or regulatory agencies taking civil or criminal action against the Company, its affiliates or its current or former employees. Defense and settlements costs associated with defending and responding to any civil or criminal action can be substantial. The likelihood or consequences of such investigative actions are unclear at this time but could include financial or other penalties and could have a material adverse effect on the Company and the value of the Common Shares.

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

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

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

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

14. Risk Factors continued

Risks Relating to the Company's Projects in Mongolia continued

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

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

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

Pursuant to the Specified Areas Law, the Government of Mongolia has defined the boundaries of certain areas in which exploration and mining is purportedly prohibited. A list of licences has been prepared that overlap with the prohibited areas described in the law based on information submitted by water authority agencies, forest authority agencies and local authorities for submission to the Government of Mongolia.

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

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

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

14. Risk Factors continued

Risks Relating to the Company's Projects in Mongolia continued

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

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

In order to address the issues facing its implementation, in February, 2015 the Parliament of Mongolia adopted an amendment to the Law on Implementation of the Mining Prohibition in Specified Areas Law (the "Amended Law on Implementation"). The Amended Law on Implementation provides an opportunity for license holders covered within the scope of application of the Mining Prohibition in Specified Areas Law to continue their mining operations subject to advance placement of funds to cover 100% of the future environmental rehabilitation costs. A model contract and a specific Government regulation on this requirement will be adopted by the Government. The license holders must also apply within 3 months after the amendment to the Law on Implementation comes into effect for permission to MRAM to resume activities. The Company submitted its application with respect to its mining licenses before the deadline set on June 16, 2015 and hasn't yet received any communication from MRAM on the status of its application.

Pursuant to the Mongolian Law "To prohibit mineral exploration and mining operations at headwaters of rivers, water protection zones and forested areas", the Government administrative agency has notified the Company that special license area 12726A is partly overlapping with a water reservoir. The Company has inspected the area together with the Cadastral Division of the Mineral Resource Authority as well as through the cadastral registration system of the Ministry of Environment, it is determined that 29 hectares of Sukhait Bulag is partly overlapping with a water reservoir, of which has been partly handed over. (Resolution No.6/7522 issued on September 29, 2015 by the Head of Cadastral Division of the Mineral Resource Authority).

In accordance with Article 22.3 of Law of Mongolia on Water, 5,602.96 hectares of land, including Sukhaityn Bulag, Uvur Zadgai, and Zuun Shand pertaining to exploration license 9443X, which was converted to mining license MV-0125436 in January 2016, is overlapping with a protected area boundary. The overlapping area has been officially handed over to the local administration. (Resolution No.688 issued on September 24, 2015 by the Head of Cadastral Division of the Mineral Resource Authority) In connection with the nullification of Annex 2 of the Government order No.194 "On determining boundary" issued on June 5, 2012, area around the water reservoir located at MV-016869 license area and Soumber exploration license 9449X, which was converted to mining license MV-020451 in January 2016, was annulled from the Specified Area Law.

Therefore, mining license 12726A and MV-016869 and exploration licenses 9443X, 9449X were removed from the list of licenses that overlaps with the prohibited areas described in the law.

There has been limited development of the law during 2016 while two exploration licenses of the Company (13779X and 5267X) were converted to mining licenses (MV-020676 and MV-020675) in November 2016. The Company will continue to monitor the developments and ensure that it follows the necessary steps in the Amended Law on Implementation to secure its operations and licenses and is fully compliant with Mongolian law.

14. Risk Factors continued

Risks Relating to the Company's Projects in Mongolia continued

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

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

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

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

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

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

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

Under the 2006 Minerals Law, the State Great Khural of Mongolia (the "Parliament of Mongolia") has wide discretion to designate mineral deposits to be Mineral Deposits of Strategic Importance. The Government of Mongolia is empowered to participate on an equity basis with the licence holder in the exploitation and/or mining of each Mineral Deposit of Strategic Importance on terms to be negotiated between the Government of Mongolia and such licence holder. Details of any minerals reserves must be filed by the relevant licence holder with the Government of Mongolia, and those deposits on the Strategic Deposits List represent most of the largest and highest profile deposits in Mongolia. In addition to deposits currently on the Strategic Deposits List and the additional Tier 2 Deposits List, the Parliament of Mongolia may at any time designate other deposits not yet currently on such Lists to be Mineral Deposits of Strategic Importance, add such deposits to either the Strategic Deposits List or the Tier 2 Deposits List and, in the former case, commence negotiations with the relevant licence holder with respect to the terms under which the Government of Mongolia will take an interest in such deposit. While the Government of Mongolia is in the process of adding the exact location and coordinates for each Mineral Deposit of Strategic Importance, a number of deposits on the Strategic Deposits List are identified by name only with no indication of the latitude and longitude coordinates for the deposit, and it is therefore not always possible to precisely determine the intended geographic area covered by each designated Mineral Deposit of Strategic Importance or to accurately determine whether or not any given licence area is within, or overlaps, a Mineral Deposit of Strategic Importance. In July 2014, the Mongolian Parliament made an amendment to the Minerals Law and redefined the term of "Mineral Deposit of Strategic Importance". According to the Minerals Law, the Mineral Deposit of Strategic Importance means "a deposit which can affect national security, national economic and social development or a deposit that can produce more than five percent of Mongolian GDP in a year".

14. Risk Factors continued

Risks Relating to the Company's Projects in Mongolia continued

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

Under the 2006 Minerals Law, the size of the Government of Mongolia's participation is determined largely by the level of state funding which has been provided for the exploration and development of any deposit, with the Government of Mongolia entitled to participate up to 50% in the event that there has been state funding of such deposit and up to 34% if there has not. However, the 2006 Minerals Law is very vague as to the details and method by which the Government of Mongolia will take its interest and the final arrangements in respect of the Government of Mongolia's interest in each Mineral Deposit of Strategic Importance, including the amount of compensation to be paid to the licence holder and the actual form of the Government of Mongolia's interest are subject to negotiation between the Government of Mongolia and the licence holder. In 2015, the Parliament of Mongolia adopted an amendment to the 2006 Minerals Law providing for the possibility for the Government to collect a special royalty on Mineral Deposits of Strategic Importance in lieu of holding an equity stake in such deposit. It stipulates that the parties can agree to transfer to the licence holder the state's share in the Mineral Deposit of Strategic Importance upon the approval of an authorized Government body, with the licence holder agreeing to pay a special royalty at a percentage (not to exceed 5%) to be approved by the Government.

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

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

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

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

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

14. Risk Factors continued

Risks relating to the Company's business and industry

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

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

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

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

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

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

14. Risk Factors continued

Risks relating to the Company's business and industry continued

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

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

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

Mineral resources that are not mineral reserves do not have demonstrated economic viability. Due to the uncertainty that may attach to inferred mineral resources, there is no assurance that mineral resources will be upgraded to proven and probable ore reserves. Inferred mineral resources are considered too speculative geologically to have economic considerations applied to them that would enable them to be categorized as mineral reserves.

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

The Company expects that a majority if not all of the coal sales from the Ovoot Tolgoi Mine will be made to customers based in China. Accordingly, the economic, political and social conditions, as well as government policies, of China may affect its business. The Chinese economy differs from the economies of most developed countries in many respects, including: (i) structure; (ii) level of government involvement; (iii) level of development; (iv) growth rate; (v) control of foreign exchange; and (vi) allocation of resources. The Chinese economy has been transitioning from a planned economy to a more market-oriented economy. For the past two decades, the Chinese government has implemented economic reform measures emphasizing the utilization of market forces in the development of the Chinese economy. Changes in the Chinese's political, economic and social conditions, laws, regulations and policies could materially and adversely affect the Company's business and results of operations.

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

14. Risk Factors continued

Risks relating to the Company's business and industry continued

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

As at March 28, 2018:

- CIC holds a total of 64.8 million Common Shares representing approximately 23.8% of the issued and outstanding Common Shares;
- Novel Sunrise holds a total of approximately 46.4 million Common Shares representing approximately 17.0% of the issued and outstanding Common Shares; and
- Voyage Wisdom holds a total of approximately 25.8 million Common Shares representing approximately 9.5% of the issued and outstanding Common Shares.

Accordingly, the Company's principal stakeholders may have the ability to substantially affect the outcome of matters submitted to Shareholders of the Company for approval, including, without limitation, the election and removal of directors, amendments to our articles of incorporation and bylaws and the approval of any business combination. This may delay or prevent an acquisition of the Company or cause the market price of Common Shares to decline. The interests of each of these principal stakeholders may conflict with the interests of other Shareholders and there is no assurance that any of these principal stakeholders will vote its Common Shares in a way that benefits minority Shareholders. While no Shareholder has the ability to elect a majority of the Board unilaterally, both Novel Sunrise and CIC have been granted contractual director appointment rights. In addition, the Company's principal stakeholders may have an interest in pursuing acquisitions, divestitures and other transactions that, in the judgment of management, could enhance its equity or debt investment, even though such transactions might involve risks to other Shareholders and may negatively affect prevailing market prices of the Common Shares.

Subject to compliance with applicable securities laws, the principal stakeholders may sell some or all of their Common Shares in the future. No prediction can be made as to the effect, if any, such future sales of Common Shares will have on market prices of the Common Shares prevailing from time to time. However, the future sale of a substantial number of Common Shares by our principal stakeholders, or the perception that such sales could occur, could adversely affect prevailing market prices of the Common Shares.

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

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

The Mongolian tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged by tax authorities. As a result, significant additional taxes, penalties and interest or royalties 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.

14. Risk Factors continued

Risks relating to the Company's business and industry continued

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

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

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 with the royalty regime. From February 1, 2016 onwards, royalties are to be 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 costs 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. There can be no assurance, however, that the Government of Mongolia will not disagree with the methodology employed by the Company in determining the calculated sales price and deem such price "non-market" under Mongolian tax law, which could have a material adverse effect on the business and operations of the Company and may negatively affect the price and volatility of the Common Shares.

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

As of December 31, 2017, management has assessed that recognition of a provision for uncertain tax position is not necessary.

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

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

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

14. Risk Factors continued

Risks relating to the Company's business and industry continued

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

The Company's activities are subject to extensive licensing and permitting requirements. The Company strives to obtain all required licenses and permits on a timely basis and to comply with all such licenses and permits at all times. However, there can be no assurance that the Company will obtain and maintain all required licenses and permits or that it will not face delays in obtaining all required licenses and permits, renewals of existing licenses and permits, additional licenses and permits required for existing or future operations or activities, or additional licenses and permits required by new legislation. The Company notes the following with respect to its ability to obtain and maintain applicable licenses and permits:

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

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

- On February 13, 2015, the License Areas were included into a special protected area (referred to as a Special Needs Territory or "SNT") newly set up by the Umnugobi Aimag's CRKh to establish a strict regime on the protection of natural environment and prohibit mining activities in the territory of the SNT.

14. Risk Factors continued

Risks relating to the Company's business and industry continued

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

- 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 CRKh election was held. As a result, the Company is aware that additional action may be taken in respect of the SNT; however, the Company has not yet received any indication on the timing of the next session of the CRKh. The Company is confident of a positive outcome in its challenge of this new CRKh resolution; however, there is no assurance that the Company will receive adequate compensation and its business and results of operation might be adversely and materially affected.

The inability to obtain or maintain licenses and permits with respect to its mining operations, of any delay with respect to the obtaining of licenses and permits, could have a material adverse impact on the Company's financial performance, cash flow and results of operations.

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

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

14. Risk Factors continued

Risks relating to the Company's business and industry continued

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

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

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

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

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

14. Risk Factors continued

Risks relating to the Company's business and industry continued

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

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

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

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 is expected to significantly increase the safety of coal transportation, reduce environmental impacts and improve efficiency and capacity of coal transportation. The paved highway is expected to have a carrying capacity in excess of 20 million tonnes of coal per year.

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

In addition, the Company has been experiencing delays with respect to the custom clearance process at the Shivee Khuren Border Crossing since July 2017. These delays have caused typical turnaround times for coal exporting trucks to double. The Company continues to closely monitor the situation. There can be no assurances that delays with respect to the custom clearance process at the Shivee Khuren Border Crossing will improve. Continued delays may have a material adverse impact on the Company's financial performance, cash flow and results of operations.

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

14. Risk Factors continued

Risks relating to the Company's business and industry continued

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

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

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

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

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

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

14. Risk Factors continued

Risks relating to the Company's business and industry continued

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

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

In order to address the continuing difficult coal market conditions in China, the Company has initiated a plan to change the existing product mix to higher value and higher margin outputs through a plan to commence washing certain grades of coal commencing in 2018 in order to produce more premium semi-soft coking coal and to initiate more processing of the lower grades of coal in order to reduce the ash content and improve the selling price and margins on its thermal coal product. The current mine plan incorporates coal washing and processing systems and significantly higher volumes of production in order to complement the Company's projected new product mix and sales volume targets. Such plans are expected to involve the need for a significant level of stripping activities over the next two years and certain capital expenditures to achieve the designed production outputs. Such expenditures will require the Company to seek additional financing in the form of finance leases, debt or equity. The Company is currently in negotiations to finalize an agreement for a finance lease on the new wash plant facility but expects to need additional financing to complete the thermal coal processing facilities.

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

Additionally, the Company has been selling its coal products since 2008. The Company had 20 active customers with the largest customer representing approximately 25%, the second largest customer representing approximately 19%, the third largest customer representing approximately 11%, the fourth largest customer representing approximately 10% and the remaining customers accounting for 35% of the Company's total sales for the year ended December 31, 2017. In order to mitigate this risk, the Company is attempting to modify its sales strategy in order to expand its existing customer base. With certain of its customers, the Company has accepted payment for coal deliveries in the form of bank instruments, in lieu of cash. There can be no assurance, however, that the Company will be able to satisfy or comply with the funding conditions of such instruments following completion of the coal delivery or the bank that issues the instrument will be capable of paying all or any portion of the proceeds to the Company, which could have a material adverse effect on the business and operations of the Company and may negatively affect the price and volatility of the Common Shares.

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

14. Risk Factors continued

Risks relating to the Company's business and industry continued

The results of the internal investigation conducted by the Special Committee may reveal that the Company is exposed to potential liabilities.

Mr. Aminbuhe, the Company's former Chairman and Chief Executive Officer, was arrested on October 11, 2017 as a suspect in a fraudulent loan case. The Company formed a Special Committee to initiate a formal internal investigation into the charges against Mr. Aminbuhe and the connection, if any, between those charges and the Company and his conduct as Chairman and Chief Executive Officer of the Company. If the results of the internal investigation uncovers any potential wrongdoing involving the Company, the Company may be the subject of enforcement or litigation, including the payment of fines and/or penalties. The Company may also sustain reputational harm and the general business of the Company may suffer. Should the Company incur such liability or business harm, it could have a material adverse impact on the Company's financial performance, cash flow and results of operations, which may negatively affect the price and volatility of the Common Shares and any investment in such shares could suffer a significant decline.

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

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

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

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

The Company currently does not own a coal storage facility at the Ceke border. As a result of potential stricter requirements for the coal storage facilities which may be adopted by the local government in the future, the Company may not be able to secure enough storage space at the Ceke border, which could have a material adverse effect on the business and operations of the Company and may negatively affect the price and volatility of the Common Shares. The proposal to develop the Ceke Logistics Park Project has been driven, in part, to address these potential regulatory requirements; however, there is no guarantee that the Ceke Logistics Park Project can meet any new requirements which may be adopted by the local government.

14. Risk Factors continued

Risks relating to the Company's business and industry continued

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

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

Risks relating to the development of the Ceke Logistic Park Project

On October 10, 2017, the Company entered into the Investment Agreement with BDRT in connection with the Company's development of the Ceke Logistics Park. Development of the Ceke Logistics Park project is subject to numerous risks, including, but not limited to, delays in obtaining equipment, material and services essential to developing the project in a timely manner; changes in environmental or other government regulations; permitting and regulatory approvals; currency exchange rates; labour shortages; and fluctuation in metal prices. In addition, there can be no assurance that the Company or BDRT will have the financial, technical and operational resources to complete the development of the Ceke Logistic Park project in accordance with the Company's current plans or completed on time or on budget.

The Ceke Logistics Park project is also subject to risks normally associated with the development of a project involving an investment partner, including: (i) disagreement with an investment partner about how to develop, operate or finance operations; (ii) that an investment partner may not comply with the underlying agreements governing project development and may fail to meet its obligations thereunder to the Company or to third parties; (iii) that an investment partner may at any time have economic or business interests or goals that are, or become, inconsistent with the Company's interests or goals; (iv) the possibility that an investment venture partner may become insolvent; and (v) the possibility of litigation with an investment partner. As of the date of this MD&A, IMSE has received RMB 15 million from BDRT pursuant to the Investment Agreement.

Foreign currency fluctuations could affect expenses and any future earnings.

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

14. Risk Factors continued

Risks relating to the Company's business and industry continued

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

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

Future stock market conditions may change.

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

Information in this MD&A regarding future plans reflects current intentions and is subject to change.

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

15. Outlook

Following the termination of the enforcement procedure in relations to the Tax Verdict in January 2018, the dispute giving rise to the Tax Verdict has been fully resolved. The Company will continue to work closely with the Mongolian authorities to ensure compliance with all applicable Mongolian rules and regulations.

With the implementation of the "One Belt, One Road" program in China, the Company is well positioned to capture the resulting business opportunities between the two countries given the potential strategic support from its largest shareholders (CIC and Cinda), which are both state-owned-enterprises in China, and its strong operational record for the past ten years in Mongolia, being one of the largest enterprises in the country.

Upon the successful launching of the Company's processing facilities in the coming months, the Company expects to produce and sell higher volumes of higher-quality coal products to the Chinese market at improved margins. The Company will continue to strive for revenue growth by expanding its customer base further inland into China.

Looking forward to 2018, the Company remains cautiously optimistic regarding the Chinese coal market.

The Company continues to make efforts to strengthen cost management to ensure operating efficiency.

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 the potential strategic support from its largest shareholders (CIC and Cinda), which are both state-owned-enterprises in China, and its strong operational record for the past ten years in Mongolia, being one of the largest enterprises in the country.

- **Strategic location** – The Ovoot Tolgoi Mine is located approximately 40km from China, which represents the Company's 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.

- **A large resources and reserves base** – As a result of work performed by DMCL for the Ovoot Tolgoi Deposit, the Company's aggregate coal resources include measured and indicated mineral resources of 194.6 million tonnes and inferred resources of 32.1 million tonnes while 114.1 million tonnes were declared as mineral reserves.

- **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.

15. Outlook continued

Objectives

The Company's objectives for 2018 and the medium term are as follows:

- **Enhance product mix** – The Company is committed to enhancing the product quality by completing the commissioning of the new wash plant, and completing a study of refurbishing, completing and implementing certain components of the former dry coal handling facility, which would enable the processing of lower grade coal into higher margin products on a larger scale.

- **Expand customer base** – The Company aims to strengthen its sales and logistics capabilities to expand the customer base further inland in China.

- **Optimize cost structure** – The Company is focused on further cost reduction by improving productivity and operational efficiency with the engagement of third party contract mining companies while maintaining product quality and the sustainability of production. Meanwhile, the Company is expecting there will be a significant level of stripping work to be performed at the Sunrise pit in the upcoming 12 months to ensure a sustainable coal production over the mine life. In order to finance the stripping work, the Company will reduce the production level while utilizing the existing balance of inventory to meet the sales target.

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

- **Diversify the risk profile of the Company** – The Company is evaluating various business opportunities besides coal mining, coal trading and real estate in Mongolia including, but not limited to, the Ceke Logistics Park.

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

March 28, 2018

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

SouthGobi believes that having sound environmental, social and governance ("ESG") performance is important to the continued sustainable development of its business and community. The Company is committed, not only in creating value for its shareholders, but also in promoting environmental protection, social responsibility and effective corporate governance.

The Board of Directors has established a Health, Environment, Safety and Social Responsibility ("HESS") Committee. The primary objective of the HESS Committee is to review and oversee the Company's established HESS policies and procedures at the Company's project sites. The HESS Committee also reviews any incidents that occur and provides guidance on how to prevent any recurrences. During the course of 2017, the HESS Committee met twice.

We uphold and value the principles of integrity and responsibility in our operations, and are constantly seeking ways to enhance our competitive edge by striving for excellence and embracing technological advances. We fulfill our social responsibility through our work in supporting the local community and by minimizing pollution to the environment. We also conduct an environmental monitoring program every year, which consists of checking soil quality, ground and surface water levels and quality, vegetation, fauna, air quality including dust and waste gas emissions, and reclamation and rehabilitation.

Being one of the largest employers in Mongolia, we provide a positive working environment and sustain strong safety guidelines for our employees to minimize the lost time injury. The Company has maintained a solid record of a low lost time injury frequency rate since establishment and a lost time injury frequency rate of 0.03 per 200,000 man hours based on a rolling 12 month average in 2017. We encourage and provide continuous training to our staff to enhance morale and improve the efficiency.

Disclosures relating to the material ESG issues identified have been included in this ESG Report pursuant to the requirements of Appendix 27 of the Listing Rules. This ESG Report mainly covers the policies, initiatives and performance of the Company's business in relation to these issues, for the year ended 31 December 2017:

A. Environmental

A1: Emissions

The Company is required and willing to comply with the Environmental Protection Law of Mongolia for its mining activities. It includes specific regulations and guidelines on the protection of the land and soil, water and air within the areas it operates. In particular, the Law on Air of Mongolia has specifically identified the standards that the Company has to reach and maintain.

Within the framework of such relevant environmental laws and regulations, the Company aspires to demonstrate environmental leadership by keeping its environmental impact at a minimum through carrying out rehabilitation, biological offsetting, regular monitoring of pollutant emissions and taking relevant responsive measures and protecting the environment with the participation of locals in the area in which it operates.

In 2014, a weather station commenced operations at the mine site in order to gather site specific data every 10 minutes, including data for gas emissions.

In 2017, the emissions of sulphur dioxide, nitrogen dioxide, respirable and fine suspended particles (known as PM10 and PM2.5) released through the mining process were within Mongolian air quality standard MNS 4585:2007. The results were derived from the Company's environmental monitoring program where samples from selected areas were taken and passed to authorized laboratory for testing.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

The results shown below demonstrates that our average results of the measured parameters were under the standard requirement for both 2016 and 2017.

	Measured parameters	Unit	Standard requirement	2016 average result	2017 average result
1	PM10 dust content	μg/m^3	0.1	0.06	**0.04**
2	PM2.5 dust content	μg/m^3	0.05	0.41	**0.039**
3	Sulphur Dioxide	μg/m^3	0.45	0.005	**0.0215**
4	Nitrogen Dioxide	μg/m^3	0.085	0.031	**0.0315**

Moreover, the Company has implemented a variety of environmental friendly waste management programs and is focused on recycling and reduction of wastes. In 2017, the Ovoot Tolgoi mine site generated 311 (2016: 278) tonnes of waste, including waste oil, used tires, car batteries and cartridges, and 73% (2016: 75%) of such were recycled and donated to local residents and various contract companies for reuse.

A2: Use of resources

The Board, together with its HESS Committee, are the highest decision-making authority in respect of energy conservation and environmental protection. The Company established a top-down management approach and assessment mechanism for energy conservation and environmental protection at three levels: head office, subsidiaries (branches) and plant (mine, section), in order to delegate responsibility, induced pressure onto each level, and connect incentives and constraints on all division.

– **Energy consumption (electricity, gas, oil)**

The details of energy consumption at mine site are as follows:

			2016		2017	
	Measured parameters	Unit	Total consumption	Per tonne produced	Total consumption	Per tonne produced
1	Electricity	kWh	1,897,407	0.56	**1,412,666**	**0.56**
2	Gas (propane, oxygen, acetylene, argon, nitrogen)	Ballon/3000 psi	162	47.9 (per million tonnes)	**93**	**47.9 (per million tonnes)**
3	Oil (Gear oil, Hydraulic oil, Engine oil)	tonnes	102	30.2 (per million tonnes)	**107**	**30.2 (per million tonnes)**

– **Water consumption**

In 2017, the Ovoot Tolgoi mine site consumed 36,161m^3 (2016: 21,296m^3) of water for domestic use. In addition, 195,135m^3 (2016: 140,555m^3) of water, which is from nearby pit and water pond, was used for dust compression. Water consumption was higher in 2017 due to increased mining operations during the year. We continue to strive to minimize the water consumption used in dust compression by reducing the source pollution and emission during the mining process.

– **Energy use efficiency initiatives**

The Company has utilized the following measures to promote energy saving:

– conduct routine camp meeting for all employees about energy use efficiency;

– erect signage to remind employees to turn off the lights when unused;

– camp manager checks the lights every night;

– heating is maintained and monitored at the correct temperature; and

– air conditioners are only utilized according to a specific schedule.

Sourcing water, water efficiency initiatives

The Company has implemented various measures to preserve water usage, especially at the mine site. We have held various meetings with our employees and local residents to promote the importance and ways to preserve water and the efficient use of water. We have placed rubbish bins at different locations of water sources near the mine site to prevent littering, which directly affects the quality of water sources. Moreover, we constantly clean the water source points to ensure the water quality supplied to Ovoot Tolgoi and the nearby community.

A3: The Environment and Natural Resources

The Company adheres to the notion of producing green coal and building ecological mining sites. Great emphasis has been laid on soil and water conservation, land rehabilitation and greening, ecological projects and other efforts as motions to safeguard and improve local eco-environment and strive to advance the ecological progress.

The Company established annual environmental monitoring programme to monitor soil quality, underground water, reclamation and rehabilitation.

The Ovoot Tolgoi mining license area does not have large scale soil contamination by heavy metals often associated with mining operations. Samplings were taken in 39 different locations and the results were all within the government standard requirement under MNS 5850:2008. The overall results for 2016 and 2017 are as follows:

For 2016:

Heavy metals	Unit	Chromium	Lead	Cadmium	Nickel	Zinc
Average	Mg/kg	32.5	0.16	0.13	17.52	38.62
Maximum	Mg/kg	66.13	2.42	1.25	30.6	91
Minimum	Mg/kg	4.55	0	0	4.13	3.01
MNS 5850:2008	Mg/kg	150	100	3	150	300

For 2017:

Heavy metals	Unit	Chromium	Lead	Cadmium	Nickel	Zinc
Average	**Mg/kg**	**30.1**	**19**	**0.22**	**17.5**	**96**
Maximum	**Mg/kg**	**70.2**	**40.2**	**1.11**	**28.6**	**170.6**
Minimum	**Mg/kg**	**9.2**	**8.9**	**0.008**	**7.3**	**20.2**
MNS 5850:2008	**Mg/kg**	**150**	**100**	**3**	**150**	**300**

The Company also tested 14 surface water points to monitor underground water quality. A total of 13 ions, acidity, and minimization were tested and the results were all up to standard.

Mining, rehabilitation and greening at Ovoot Tolgoi are conducted in a synchronized manner. Timely rehabilitation and greening has been carried out in accordance with the procedure of topsoil stripping, layering up, mining, back-filling, covering the topsoil and restoring vegetation, which enables a full-scale greening and restores the ecology to its pre-mining conditions. Since 2008, the Company carried out biological reclamation of a 52.86 hectare area and planted over 3,000 trees and shrubs to reduce greenhouse gas emissions.

The Company is required to develop an environmental protection plan each year. The plan for 2018 has been approved by the Ministry of Environment and Green Development of Mongolia. 54 activities were planned to minimize the impact on environment, including but not limited to air, soil, underground water, plants and animals.

B. Social

B1: Employment

The Company upholds an equal and non-discriminative employment policy to provide equal employment opportunities for all candidates, regardless of nationality, race, gender, religion belief and cultural background. Taking into account characteristics and development requirements of different positions, the Company actively provides job opportunities for women and ensures equal pay for equal work for both male and female employees. As of December 31, 2017, the Company had a workforce of 489 employees, including 98 female employees, representing 20% of the workforce. In 2017, the Company recruited 161 employees.

The Company believes that a diverse board will enhance the decision making of the Board by utilizing the difference in skills, experience and background, geographical and industry experience, ethnicity, gender, knowledge and length of services, and other distinguishing qualities of the members of the Board. In support of this belief, the Board adopted a Board Diversity Policy in March 2014. All Board appointments will continue to be based on merit, having due regard to the overall effectiveness of the Board and diversity will be one of the criteria considered in determining the optimum composition of the Board.

To retain the competitive employees, the Company has in place remuneration and welfare mechanism that are internally fair and externally competitive. The Company has implemented the appropriate policies and campaigns to encourage and incentivize employees to develop and realize their personal values. Based on annual performance appraisal, the Company paid salary, bonus and allowance totaling US$8.0 million to employees in 2017 (2016: US$7.0 million).

Employees are entitled to paid leave, maternity leave, paternity leave and other statutory leave in accordance with the law. The Company also provides paid sick leave and personal leave, granting 15 days of annual paid leave on average for the employees in 2017.

B2: Health and Safety

The health and safety of the Company's employees is a top priority and the Company constantly improves the occupational safety and health management system in order to reduce risks and create a safe working environment. The Company requires all employees to strictly comply with the health and safety policies.

The Company's safety management system is designed on the principles of continual improvement and adopts the "Plan, Do, Check and Review" methodology. The structure of the safety management system generally follows the layout of international standards such as MNS OHSAS 18001:2012 and AS/NZS 4801.

The system has 17 elements which are inter-related, and each of those have specific objective which enables the employees to identify and manage various health and safety threats. Each element includes measures which help employees meet the requirements of respective objective. Some of the elements refer to fixed procedures that must be followed, and defined in safe work procedures. The health and safety performance standards also address specific risk areas and the precautions and guidelines set by the health and safety performance standards are mandatory for all employees.

As at December 31, 2017, the Company had a lost time injury frequency rate of 0.03 per 200,000 man hours based on a rolling 12-month average.

B3: Development and Training

The Company has conducted various training activities and has in place ongoing mechanisms for employees to enhance their skills and capabilities in order to provide a career development path for employees and to improve the efficiency of the Company.

In particular, there are various trainings in relation to health and safety at the mine site. We ensure all personnel involved in any operation or activities at mine site are knowledgeable of the risks and controls associated with and they are competent to perform those activities. All new employees, contractors and visitors of mine site must undertake relevant induction training, which includes reference to the significant health and safety risks identified at the managed site.

The health and safety training includes two major aspects: competency-based training and awareness training. Competency-based training provides training on risk analysis, operational controls, work place monitoring, management of change and incident management. Awareness training includes significant health and safety risks and activities, accountabilities of specific health and safety roles and responsibilities, and emergency response procedures.

During 2017, safety training was provided for 2,530 employees (2016: 1,664) which includes new employee training, refresh training, contractor new employee training, contractor refresher training and visitor induction. A total of 30,360 training hours was given in 2017 (2016: 19,968).

B4: Labour standards

The Company strictly prohibits the use of child and forced labour in all operations, and is committed to creating a work environment which respects human rights.

In strict compliance with laws and regulations regarding labour and human rights, the Company takes such measures as instituting and enhancing collective contract system, signing labour contracts with each employee, improving remuneration and welfare mechanism and strengthening occupational health management to protect employees' legitimate rights and interests. In case of any violation, the Company will carry out investigation and impose necessary action on the employing unit and demand rectification within a specified period. No breach of any standards, rules or regulations on child labour and forced labour has ever occurred.

B5: Supply Chain Management

The Company has been continuously improving its supply chain management, not only ensuring the stable supply of production materials and services, but also managing the suppliers to be in line with the Company's core values to uphold the environmental and social standards.

The Company regards the social value and social influence (especially the fulfilment of social responsibility) as important aspects in supplier assessment and enhanced admission management. According to specific admission requirements, the Company not only demands that a supplier presents certification of quality, environment and occupational health and safety regimes, but that the supplier's product and its production meets national environmental protection standards and regulations and has passed external expert assessment.

According to the Company's procurement guidelines, the agreements with suppliers include the Company's requirement and standards in terms of environment and safety concerns. The tools and equipment by the contractors are all inspected and evaluated to be in safe condition and confirm with the Company health and safety standards and site procedures.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

B6: Product Responsibility

The Company's main coal products are the premium semi-soft coking coal, the standard semi-soft coking coal and the thermal coal. We strive to ensure steady supply of quality coal products to customers.

The Company actively promotes clean coal products featuring low sulphur, low ash and high calorific value. We sell coals with low ash and sulphur level with high calorific value. In general, our products ash level ranged from 12% to 28% with calorific value of 5,000 to 7,000 kcal/kg. The sulphur content is below 1.7% for most of our products. During 2017, we processed and screened 1.07 million tonnes of coal in order to lower the ash level.

In the fourth quarter of 2016, the Company initiated a plan to change the existing product mix to higher value and higher margin outputs by washing certain grades of coal in order to produce more premium semi-soft coking coal and to initiate more processing of the lower grades of coal in order to reduce the ash content and improve the selling price and margins on its thermal coal product. The construction of the wash plant was substantially completed in 2017, however commencement of washing has been delayed to the second quarter of 2018.

B7: Anti-corruption

Through the coordination of supervisory functions such as over-site, inspection, audit, petitioning and deploying supervisory committees, the Company continues to promote the construction of a monitoring system, strengthening the accountability and awareness of supervisory duties in all its employees, making greater effort to monitor corruption, devoting vigorous efforts to supervision and accountability, thereby accomplishing significant results in terms of building up the Company's culture and anti-corruption.

In 2012, the Company adopted the implementation of a revised Code of Business Conduct and Ethics (the "Ethics Policy") called "*The Way We Work*". The Ethics Policy is applicable to all employees, consultants, officers and Directors regardless of their position in the organization, at all times and everywhere the Company does business. It has clear guidelines in relation to anti-bribery due diligence, and standards relating to anti-corruption and conflicts of interest.

In addition to "*The Way We Work*", the Company has also adopted additional guidance notes and standards which form part of the Company's overall Ethics Policy. The guidance notes and standards adopted include: guidelines for investigations into allegations of serious wrongdoing, dawn raid guidance notes, anti-bribery due diligence guidelines, business integrity standards relating to anti-corruption and conflicts of interest (collectively "Code of Conduct Standards"), and the EthicsPoint program.

EthicsPoint is the Company's confidential whistleblowing program, which is administered by an independent third party, and is available for use when someone suspects or is aware of illegal, unsafe or inappropriate activity at work. EthicsPoint provides avenue for individuals to raise concerns confidentially and anonymously.

B8: Corporate Social Responsibility

SouthGobi proactively cares for the needs of the community by creating job opportunities, supporting the necessities of the community especially for small businesses and children educations, and committed to contribute to the long term development of Mongolia.

The Company encourages the employment of staff from the local community based on the principal of harmonious development. The Company's Ovoot Tolgoi Mine has created job opportunities in the Umnugobi Aimag (South Gobi province). The Company has 432 employees in Mongolia, of which 397 (92%) are Mongolian nationals and of those, 210 (53%) are residents of the local Gurvantes, Dalanzadgad, Sevrei and Noyon Soums.

The Company also supports and participates in the economic construction of the surrounding regions while developing. Thus, the Company enjoys a good relationship with the local enterprises and government by supporting the local communities. For instance, the Company purchase goods and materials from the locals, such as purchasing the employees' uniforms through domestic suppliers. The Company also supplies and donates coal for the nearby residents during the winter.

Moreover, the Company has implemented scholarship program to support local students in the Gobi region, which grants scholarships to 20 outstanding students annually. The Company also built infrastructures for the local communities, constructed a new kindergarten in the Gurvantes Soum region in 2011, and, in 2017, the Company renovated the library for a secondary school in the Gurvantes Soum region. Each year, SouthGobi Sands hosts sporting events and festivals for the local schools, and also co-organizes the English assessment exam, Olympiad. This year, SouthGobi Sands initiated "A Good Book is a Good Friend" campaign together with the Central Library and the Office of Education and Culture of Umnugobi province, which aimed at encouraging more people to read books and cultivating reading habits among students.

The inputs and support that SouthGobi has contributed to the communities over the years has been acknowledged and recognized, and the Company was honoured to receive various awards in the past years. In 2017, SouthGobi was proud to receive the following awards: the best "Social Responsibility Enterprise of Silk Road" by Mongolian National Chamber of Committee, the "Mongolian Outstanding Employers of the Year" by the Mongolian government, the "Entrepreneur Who Assures Workplace Health and Safety" by Umnugobi Aimag's Department of Labor and Social Welfare, and the "Best Corporate Social Responsibility Enterprise of Umnugobi Province" by the Umnugobi Branch of the Mongolian National Chamber of Commerce and Industry.

In addition, SouthGobi Sands concluded a cooperation agreement for construction of the 42-units residential apartment buildings in Gurvantes Soum of Umnugobi province, together with the Governor Office of Gurvantes Soum, State Housing Corporation and Mongol 333 Corporation. This project aimed to provide four apartment buildings, a total of 42 units to residents who lives in the Gurvantes Soum and employees of SouthGobi Sands for better quality and affordable housing. These apartments would be the first apartment that connects to the water and electricity network in the Gurvantes Soum. The groundbreaking ceremony was held on October 2^{nd}, 2017 and the construction of the apartments are expected to be finished by the end of 2018.

During 2017, SouthGobi made US$65,085 in charitable donations, of which includes cash donations for different communities including scholarships, coal donations, and airfare sponsors for local residents of Gurvantes as transportation between Ulaanbaatar and Ovoot Tolgoi.

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.


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SouthGobi Sands

CONSOLIDATED FINANCIAL STATEMENTS

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INDEPENDENT AUDITOR'S REPORT

To the Shareholders of SouthGobi Resources Ltd.

We have audited the accompanying consolidated financial statements of SouthGobi Resources Ltd., which comprise the consolidated statements of financial position as at December 31, 2017 and December 31, 2016 and the consolidated statements of comprehensive income, changes in equity and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditor's responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of SouthGobi Resources Ltd. as at December 31, 2017 and December 31, 2016 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Emphasis of matter

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

signed "PricewaterhouseCoopers LLP"
Chartered Professional Accountants
Vancouver, Canada
March 28, 2018

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

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

	Notes	Year ended December 31, 2017	2016
Revenue	5	**$ 120,973**	$ 58,450
Cost of sales	7	**(105,858)**	(87,045)
Gross profit/(loss)		**15,115**	(28,595)
Other operating expenses	8	**(11,264)**	(50)
Administration expenses	9	**(9,181)**	(7,888)
Evaluation and exploration expenses		**(273)**	(422)
Impairment of property, plant and equipment	18	**(11,171)**	(1,152)
Loss from operations		**(16,774)**	(38,107)
Finance costs	10	**(22,958)**	(22,314)
Finance income	10	**164**	239
Share of earnings of a joint venture	19	**1,287**	806
Loss before tax		**(38,281)**	(59,376)
Current income tax expense	11	**(1,740)**	(1,470)
Net loss attributable to equity holders of the Company		**(40,021)**	(60,846)
Other comprehensive income/(loss) to be reclassified to profit or loss in subsequent periods			
Exchange differences on translation of foreign operations	19	**421**	(3,883)
Net comprehensive loss attributable to equity holders of the Company		**$ (39,600)**	$ (64,729)
Basic and diluted loss per share	12	**$ (0.15)**	$ (0.24)

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

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

(expressed in thousands of U.S. Dollars)

	Notes	As at December 31, 2017	2016
Assets			
Current assets			
Cash and cash equivalents		**$ 6,471**	$ 966
Trade and other receivables	13	**16,486**	19,434
Notes receivables	14	**12,520**	–
Inventories	16	**36,389**	28,583
Prepaid expenses and deposits	17	**6,286**	8,194
Total current assets		**78,152**	57,177
Non-current assets			
Properties for resale	15	**8,906**	–
Property, plant and equipment	18	**152,457**	180,809
Investment in a joint venture	19	**21,052**	21,335
Total non-current assets		**182,415**	202,144
Total assets		**$ 260,567**	$ 259,321
Equity and liabilities			
Current liabilities			
Trade and other payables	20	**$ 79,219**	$ 43,628
Deferred revenue	23	**27,644**	29,849
Interest-bearing borrowings	24	**7,352**	8,454
Current portion of convertible debenture	25	**116,374**	25,597
Provision for commercial arbitration	21	**13,884**	–
Provision for court case penalty	22	**–**	9,074
Total current liabilities		**244,473**	116,602
Non-current liabilities			
Interest-bearing borrowings	24	**341**	425
Convertible debenture	25	**–**	91,993
Decommissioning liability	26	**5,213**	4,288
Total non-current liabilities		**5,554**	96,706
Total liabilities		**250,027**	213,308
Equity			
Common shares	27	**1,098,623**	1,094,619
Share option reserve	29	**52,463**	52,340
Exchange reserve		**(4,737)**	(5,158)
Accumulated deficit	27	**(1,135,809)**	(1,095,788)
Total equity		**10,540**	46,013
Total equity and liabilities		**$ 260,567**	$ 259,321
Net current liabilities		**$ (166,321)**	$ (59,425)
Total assets less current liabilities		**$ 16,094**	$ 142,719

Corporate information and going concern (Note 1), commitments for expenditure (Note 34) and contingencies (Note 35)

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

APPROVED BY THE BOARD:

"Mao Sun"

Director

"Yulan Guo"

Director

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

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

	Number of shares		Common shares		Share option reserve		Exchange fluctuation reserve		Accumulated deficit		Total
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	15		1		–		–		–		1
Share-based compensation charged to operations	–		–		48		–		–		48
Net loss for the year	–		–		–		–		(60,846)		(60,846)
Exchange differences on translation of foreign operations	–		–		–		(3,883)		–		(3,883)
Balances, December 31, 2016	257,698	$	1,094,619	$	52,340	$	(5,158)	$	(1,095,788)	$	46,013
Balances, January 1, 2017	**257,698**	**$**	**1,094,619**	**$**	**52,340**	**$**	**(5,158)**	**$**	**(1,095,788)**	**$**	**46,013**
Shares issued for:											
Interest settlement on convertible debenture	**14,892**		**4,000**		**–**		**–**		**–**		**4,000**
Employee share purchase plan	**17**		**4**		**–**		**–**		**–**		**4**
Share-based compensation charged to operations	**–**		**–**		**123**		**–**		**–**		**123**
Net loss for the year	**–**		**–**		**–**		**–**		**(40,021)**		**(40,021)**
Exchange differences on translation of foreign operations	**–**		**–**		**–**		**421**		**–**		**421**
Balances, December 31, 2017	**272,607**	**$**	**1,098,623**	**$**	**52,463**	**$**	**(4,737)**	**$**	**(1,135,809)**	**$**	**10,540**

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

CONSOLIDATED STATEMENT OF CASH FLOWS

(Expressed in thousands of U.S. Dollars)

	Notes	Year ended December 31, 2017	2016
Operating activities			
Loss before tax		**$ (38,281)**	$ (59,376)
Adjustments for:			
Depreciation and depletion		**29,355**	40,666
Share-based compensation	28	**123**	48
Finance costs	10	**22,958**	22,314
Finance income	10	**(164)**	(239)
Share of earnings of a joint venture	19	**(1,287)**	(806)
Interest paid		**(19,432)**	(12,680)
Income tax paid		**(649)**	(248)
Unrealized foreign exchange loss/(gain)		**274**	(2,900)
Loss on disposal of property, plant and equipment		**27**	–
Provision/(reverse of provision) for doubtful trade and other receivables	13	**(682)**	2,641
Provision for commercial arbitration	21	**2,384**	–
Penalty on late settlement of trade payables	6	**280**	–
Impairment of inventories, net	16	**17,026**	7,354
Impairment of prepaid expenses and deposits	17	**2,517**	–
Impairment of properties for resale	15	**1,718**	–
Impairment of property, plant and equipment	18	**11,171**	1,152
Operating cash flows before changes in non-cash working capital items		**27,338**	(2,074)
Net change in non-cash working capital items	33	**(1,607)**	4,835
Cash generated from operating activities		**25,731**	2,761
Investing activities			
Expenditures on property, plant and equipment		**(20,816)**	(2,806)
Interest received		**28**	21
Proceed from disposal of item of property, plant and equipment		**111**	–
Dividend received from a joint venture	19	**1,991**	1,255
Cash used in investing activities		**(18,686)**	(1,530)
Financing activities			
Proceeds from issuance of common shares, net of issue costs		**4**	1
New loans		**3,224**	7,054
Loan arrangement fee paid		**(21)**	(252)
Repayment of interest-bearing loans		**(4,868)**	(7,382)
Cash used in financing activities		**(1,661)**	(579)
Effect of foreign exchange rate changes on cash		**121**	(63)
Increase in cash		**5,505**	589
Cash and cash equivalents, beginning of year		**966**	377
Cash and cash equivalents, end of year		**$ 6,471**	$ 966

Supplemental cash flow information (Note 33)

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

1. Corporate information and going concern

SouthGobi Resources Ltd. is a publicly listed company incorporated in Canada with limited liability under the legislation of the Province of British Columbia and its shares are listed on the Toronto Stock Exchange (Symbol: SGQ) and Hong Kong Stock Exchange (Symbol: 1878). The company, together with its subsidiaries (collectively referred to as the "Company"), is an integrated coal mining, development and exploration company. At December 31, 2017, Land Breeze II S.a.r.l., a wholly-owned subsidiary of China Investment Corporation ("CIC") owned approximately 24% of the outstanding common shares of the Company. Novel Sunrise Investments Limited ("Novel Sunrise"), a wholly-owned subsidiary of China Cinda (HK) Investments Management Company Limited ("Cinda") and Voyage Wisdom Limited each owned approximately 17% and 9% 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.

Two new Chinese subsidiaries were incorporated in 2017, Inner Mongolia SouthGobi Enterprise Co. Ltd., being the project company to develop an eco-friendly bonded logistic park at the Ceke Port, and Chongqing SouthGobi Energy Ltd., which will act as the sales window for the Southern part of China.

The registered and records office of the Company is located at 20th Floor, 250 Howe Street, Vancouver, British Columbia, Canada, V6C 2G8. The head office and principal place of business of the Company is located at 1150 – 355 Burrard Street, Vancouver, British Columbia, Canada, V6C 2G8.

Going concern assumption

The Company's consolidated financial statements have been prepared on a going concern basis which assumes that the Company will continue operating until at least December 31, 2018 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 a working capital deficiency (excess current liabilities over current assets) of $166,321 as at December 31, 2017 compared to $59,425 of working capital deficiency as at December 31, 2016. Included in the working capital deficiency at December 31, 2017 are significant obligations, which include the obligation to pay CIC under the deferral agreement dated June 12, 2017 (the "June 2017 Deferral Agreement") in which the Company was required to pay $9,731 of cash interest and associated costs on November 19, 2017 (the "June 2017 Deferral Agreement Payment"). In addition, pursuant to the terms of CIC Convertible Debenture, the Company was required to pay $8,066 of anniversary cash interest on November 19, 2017 (the "November Interest Payment" and together with the June 2017 Deferral Agreement Payment, the "November 19th Payments"). The Company is in discussions with CIC for a deferral of the November 19th Payments; however, there can be no assurance that a favorable outcome will be reached. Accordingly the principal amount outstanding and all accrued and unpaid interest and other amounts owing under the CIC Convertible Debenture and the June 2017 Deferral Agreement would immediately become due and payable in the event that CIC provides notice to the Company.

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

1. Corporate information and going concern continued

Going concern assumption continued

Pursuant to a confidential partial award (final except as to costs) ("Arbitration Award") with respect to an the commercial arbitration on January 10, 2018 involving SouthGobi Sands LLC ("SGS"), a subsidiary of the Company, and First Concept Industrial Group Limited (formerly known as First Concept Logistics Limited) ("First Concept"), SGS has been ordered to repay the sum of $11,500 to First Concept, together with accrued interest at a simple interest rate of 6% per annum from the date which the prepayment was made until the date of the Arbitration Award, and then at a simple interest rate of 8% per annum until full payment. On March 23, 2018, SGS received a notice from First Concept demanding payment of the full amount of the Arbitration Award, together with the accrued interest thereon, by no later than March 30, 2018, otherwise First Concept intends to commence enforcement proceedings against SGS in respect of the Arbitration Award. In the event that First Concept applies to enforce the Arbitration Award against SGS, the Company intends to defend itself against such enforcement proceedings through independent litigation counsel; however, due to the inherent uncertainties of litigation, it is not possible to predict whether the Company will be successful in defending itself against any such enforcement proceedings. If First Concept is successful in enforcing the Arbitration Award, the Company may not be able to re-pay the sum of $11,500 and the associated interest to First Concept.

Further, the trade and other payables of the Company continue to accumulate due to liquidity constraints. The aging profile of the trade and other payables has risen as compared to that as at December 31, 2016, as follows:

	As at December 31,	
	2017	2016
Less than 1 month	**$ 20,664**	$ 14,640
1 to 3 months	**16,132**	2,493
3 to 6 months	**8,825**	2,648
Over 6 months	**33,598**	23,847
Total trade and other payables	**$ 79,219**	$ 43,628

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 being filed against the Company. No such lawsuits or proceedings are pending as at March 28, 2018.

The Company also has other current liabilities, which require settlement in the short-term, including: the $1,708 balance of the Turquoise Hill Resources Limited ("Turquoise Hill") shareholder loan ("TRQ Loan"); the principal amount of bank loan of $2,300 and associated interest due in May 2018 and the principal amount of equipment loan of $2,309 and associated interest due in August 2018.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

1. Corporate information and going concern continued

Going concern assumption continued

In the fourth quarter of 2016, the Company initiated a plan to change the existing product mix to higher value and higher margin outputs by washing certain grades of coal in order to produce more premium semi-soft coking coal and to initiate more processing of the lower grades of coal in order to reduce the ash content and improve the selling price and margins on its thermal coal product. The construction of the wash plant was substantially completed in 2017, however commencement of washing has been delayed to the second quarter of 2018.

The current mine plan incorporates the coal washing and processing systems and contemplates significantly higher volumes of production in order to complement the Company's new product mix and sales volume targets. Such plans will require a significant level of stripping activities over the next two years and certain capital expenditures to achieve the designed production outputs. Such expenditures and other working capital requirements will require the Company to seek additional financing in the form of finance leases, debt or equity.

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 December 31, 2018, then the Company is unlikely to have sufficient capital resources or cash flows from mining operations in order to satisfy its current ongoing obligations and future contractual commitments. 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.

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.

As of the date hereof, the Company is in default under the CIC Convertible Debenture and the TRQ Loan. Pursuant to the terms of the CIC Convertible Debenture, CIC may, in its discretion, provide notice to the Company and declare all principal, interest and other amounts owing under the CIC Convertible Debenture immediately due and payable, and take steps to enforce payment thereof. Pursuant to the terms of the TRQ Loan, all of the outstanding obligations under the TRQ Loan are immediately due and payable to Turquoise Hill as of the date hereof. As of the date hereof, the Company has received no indication from CIC of any intention to deliver a notice of default under the CIC Convertible Debenture or to accelerate the amounts outstanding under the CIC Convertible Debenture, or from Turquoise Hill of any intention to demand payment of the amounts outstanding under the TRQ Loan. In addition, SGS received a notice from First Concept demanding payment of the full amount of the Arbitration Award, together with the accrued interest thereon, by no later than March 30, 2018, otherwise First Concept intends to commence enforcement proceedings against SGS in respect of the Arbitration Award. If SGS fails to satisfy the Arbitration Award, First Concept intends to enforce the Arbitration Award against SGS and, if First Concept is successful in enforcing the Arbitration Award, the Company may not be able to re-pay the sum of $11,500 and the associated interest. In such case, this will represent another event of default under the CIC Convertible Debenture and CIC would have another basis 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 and associated interest to First Concept could result in voluntary or involuntary proceedings involving the Company (including bankruptcy).

1. Corporate information and going concern continued

Going concern assumption continued

Furthermore, continuing delay in securing additional financing could ultimately result in an event of default of the equipment 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 the lender of the equipment loan 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 December 31, 2017, the Company's gearing ratio was 0.02 (2016: 0.37), which was calculated based on the Company's long term liabilities to total assets. As at December 31, 2017 and December 31, 2016, the Company is not subject to any externally imposed capital requirements.

2. Basis of preparation

2.1 Statement of compliance

The consolidated financial statements, including comparatives, have been prepared in accordance with and using accounting policies in compliance with the International Financial Reporting Standards ("IFRS") and interpretations issued by the IFRS Interpretation Committee applicable to companies reporting under IFRS. The financial statements comply with IFRS as issued by the International Accounting Standards Board ("IASB").

The consolidated financial statements of the Company for the year ended December 31, 2017 were approved and authorized for issue by the Board of Directors of the Company on March 28, 2018.

2.2 Basis of presentation

The consolidated financial statements have been prepared on a historical cost basis except for certain financial assets and financial liabilities which are measured at fair value. The Company's financial instruments are further disclosed in Note 31.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

2. Basis of preparation continued

2.3 Standards issued but not yet effective

The standards that are issued up to the date of issuance of the Company's financial statements, but were not effective during the year ended December 31, 2017, are disclosed below. The Company intends to adopt these standards, if applicable, when they become effective.

IFRS 9	Financial Instruments(i)
IFRS 15	Revenue from Contracts with Customers(i)
IFRS 16	Leases(ii)

(i) Effective for annual periods beginning on or after January 1, 2018

(ii) Effective for annual periods beginning on or after January 1, 2019

IFRS 9, Financial Instruments ("IFRS 9") – classification and measurement, addresses the classification, measurement and derecognition of financial assets and financial liabilities, introduces new rules for hedge accounting and a new impairment model for financial assets. The Company does not expect the new guidance to affect the classification and measurement of its financial assets and liabilities.

There will be no impact on the Company's accounting for financial liabilities. The derecognition rules have been transferred from International Accounting Standard ("IAS") 39 Financial Instruments: Recognition and Measurement and have not been changed.

The new impairment model requires the recognition of impairment provisions based on expected credit losses rather than only incurred credit losses as is the case under IAS 39. It applies to financial assets classified at amortised cost. The Company is currently evaluating the impacts that IFRS 9 will have on its financial statements.

IFRS 15, Revenue from Contracts with Customers ("IFRS 15"), deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Revenue is recognized when a customer obtains control of a good or service and thus has the ability to direct the use and obtain the benefits from the good or service. The standard replaces IAS 18 Revenue and IAS 11 Construction Contracts, and related interpretations. The standard is effective for annual periods beginning on or after January 1, 2018 and earlier application is permitted. At this time the Company does not expect IFRS 15 to have a significant effect on revenue recognition. The Company is continuing to investigate the disclosure requirements on the new standard.

IFRS 16, Leases ("IFRS 16"), on January 13, 2016 the IASB issued IFRS 16, according to which, all leases will be recognized on the balance sheet, as the distinction between operating and finance leases is removed. Under the new standard, an asset (the right to use the leased item) and a financial liability to pay rentals are recognized. The only exceptions are short-term and low-value leases.

The Company is currently evaluating the impacts that IFRS 16 will have on its financial statements.

There are no other IFRS or IFRIC interpretations with future effective dates that are expected to have a material impact on the Company.

3. Summary of significant accounting policies

3.1 Basis of consolidation

The consolidated financial statements include the financial statements of SouthGobi Resources Ltd. and its controlled subsidiaries (Note 32).

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

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

3.2 Foreign currencies

The consolidated financial statements are presented in the U.S. dollar, which is the functional currency of SouthGobi Resources Ltd. Each entity in the Company determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency. Transactions in foreign currencies are initially recorded at the U.S. dollar rate of exchange at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the U.S. dollar rate of exchange ruling at the end of each reporting period. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate prevailing at the date of the transaction. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rate at the date when the fair value is determined.

The functional currency of the joint venture, RDCC LLC, is the Mongolian Tugrik ("MNT"). At the end of the reporting period, the assets and liabilities of the entity are translated into the U.S. dollar at the exchange rates prevailing at the end of the reporting period and the profit or loss is translated into the U.S. dollar at the weighted average exchange rate for the year. The resulting exchange differences are recognized in other comprehensive income and accumulated in the exchange fluctuation reserve. On disposal of a foreign operation, the component of other comprehensive income relating to that particular foreign operation is recognized in profit or loss.

3.3 Borrowing costs

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

3. Summary of significant accounting policies continued

3.4 Inventories

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

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

3.5 Leases

Leases that transfer substantially all the rewards and risks of ownership of assets to the Company, other than legal title, are accounted for as finance leases. At the inception of a finance lease, the cost of the leased asset is capitalized at the present value of the minimum lease payments and recorded together with the obligation, excluding the interest element, to reflect the purchase and financing. Assets held under finance leases, including prepaid land lease payments under finance leases, are included in property, plant and equipment, and depreciated over the shorter of the lease terms and the estimated useful lives of the assets. The finance costs of such leases are charged to profit or loss so as to provide a constant periodic rate of charge over the lease terms.

Assets acquired through hire purchase contracts of a financing nature are accounted for as finance leases, but are depreciated over their estimated useful lives.

Leases where substantially all the rewards and risks of ownership of assets remain with the lessor are accounted for as operating leases. Where the Company is the lessee, rentals payable under operating leases net of any incentives received from the lessor are charged to profit or loss on the straight-line basis over the lease terms.

3.6 Property, plant and equipment

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

3. Summary of significant accounting policies continued

3.6 Property, plant and equipment continued

Initial recognition

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

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

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

Depreciation and depletion

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

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

Upon disposal, reclassification to assets held for sale or when no future economic benefits are expected to arise from the continued use of an asset the original cost and related accumulated depreciation is removed from property, plant and equipment. Any gain or loss arising on disposal of the asset, determined as the difference between the net disposal proceeds and the carrying amount of the asset, is recognized in profit or loss.

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

3.7 Mineral properties

Evaluation and exploration expenses

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

Production phase

Upon a mine development being ready for its intended use it enters the production phase and depletion of the mineral property is recorded on a unit-of-production basis using the estimated resources, which are expected to be mined in the mine plan, as the depletion base. Management's determination of when an asset is ready for its intended use is based on several qualitative and quantitative factors including, but not limited to, the following:

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

3. Summary of significant accounting policies continued

3.8 Development and production stripping costs

Once a property is determined to have reached technical feasibility, commercial viability and management has determined that the mineral property will be developed, the Company's subsequent exploration and evaluation and development expenses are capitalized as mineral property costs within property, plant and equipment.

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

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

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

3.9 Decommissioning, restoration and similar liabilities

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

3.10 Joint arrangements

The Company classifies joint arrangements as either joint operations or joint ventures, depending on the rights and obligations of the parties involved in the joint arrangement. Joint arrangements that are classified as joint operations require the venturers to recognize the individual assets, liabilities, revenues and expenses to which they have legal rights or are responsible. Joint arrangements that are classified as a joint venture are accounted for using the equity method of accounting. The Company accounts for its investment in RDCC LLC (Note 19) as a joint venture.

3.11 Share-based payments

Share-based payment transactions

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

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

3. Summary of significant accounting policies continued

3.11 Share-based payments continued

Equity-settled transactions

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

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

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

3.12 Earnings/(loss) per share

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

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

Diluted loss per share calculations are based on the net loss attributable to equity holders of the Company for the period divided by the weighted average number of common shares outstanding during the period plus the effects of dilutive common share equivalents. The Company uses the treasury stock method to determine the dilutive effect of stock options and other dilutive instruments. The treasury stock method assumes that proceeds received from the in-the-money options and other dilutive instruments are used to repurchase common shares at the prevailing market rate.

3.13 Taxation

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

Current income tax

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

3. Summary of significant accounting policies continued

3.13 Taxation continued

Deferred income tax

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

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

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

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

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

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

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

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

3. Summary of significant accounting policies continued

3.14 Financial assets

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

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

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

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

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

3.15 Financial liabilities

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

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

3. Summary of significant accounting policies continued

3.16 Impairment of financial assets

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

Assets carried at amortized cost

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

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

3.17 Derecognition of financial assets and financial liabilities

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

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

3.18 Impairment of non-financial assets

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

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

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

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

3. Summary of significant accounting policies continued

3.19 Cash and cash equivalents

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

3.20 Revenue recognition

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

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

3.21 Provisions

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

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

3.22 Related party transactions

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

3.23 Significant accounting judgments and estimates

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

Liquidity and 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

3. Summary of significant accounting policies continued

3.23 Significant accounting judgments and estimates continued

Liquidity and the going concern assumption continued

As of the date hereof, the Company is in default under the CIC Convertible Debenture and the TRQ Loan. Pursuant to the terms of the CIC Convertible Debenture, CIC may, in its discretion, provide notice to the Company and declare all principal, interest and other amounts owing under the CIC Convertible Debenture immediately due and payable, and take steps to enforce payment thereof. Pursuant to the terms of the TRQ Loan, all of the outstanding obligations under the TRQ Loan are immediately due and payable to Turquoise Hill as of the date hereof. As of the date hereof, the Company has received no indication from CIC of any intention to deliver a notice of default under the CIC Convertible Debenture or to accelerate the amounts outstanding under the CIC Convertible Debenture, or from Turquoise Hill of any intention to demand payment of the amounts outstanding under the TRQ Loan.

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 equipment 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 lender of the equipment loan and the lender of the bank loan, respectively.

Valuation of embedded derivatives

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

The key inputs used by the Company in its Monte Carlo simulation are further disclosed in Note 25.2 and Note 25.3. Changes in the inputs to the valuation model could impact the carrying value of the embedded derivatives in the convertible debenture and the amount of unrealized gains or losses recognized in profit or loss. The carrying value of the embedded derivatives in the Company's convertible debenture as at December 31, 2017 was a liability of $402 (2016: $540).

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.

3. Summary of significant accounting policies continued

3.23 Significant accounting judgments and estimates continued

Ovoot Tolgoi Mine cash generating unit

The Company determined that an indicator of impairment existed for its Ovoot Tolgoi Mine cash generating unit as at December 31, 2017. The impairment indicator was the uncertainty of future coal prices in China.

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 and washing assumptions, operating cost and life of mine coal production assumptions as at December 31, 2017. The Company's Ovoot Tolgoi Mine cash generating unit carrying value was $86,894 as at December 31, 2017.

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

- Coal resources and reserves as estimated by an independent third party engineering firm;
- Sales price estimates from an independent market consulting firm;
- Forecasted sales volumes in line with production levels as per the mine plan;
- Life-of-mine coal production, strip ratio, capital costs and operating costs;
- Coal processing to increase the grade and qualities of the thermal coal produced and sold; and
- A post-tax discount rate of 15.5% based on an analysis of the market, country and asset specific factors.

The impairment analysis did not result in the identification of an impairment loss or an impairment reversal and no charge or reversal was required as at December 31, 2017. The Company believes that the estimates and assumptions incorporated in the impairment analysis are reasonable; however, the estimates and assumptions are subject to significant uncertainties and judgments.

Estimated Resources

The Company estimates its mineral resources based on information compiled by appropriately qualified persons relating to the geological data on the size, depth and shape of the ore body, and requires complex geological judgments to interpret the data. Changes in resource estimates may impact the carrying value of mining interests, mine restoration provisions, recognition of deferred tax assets, and depreciation and amortization charges.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

3. Summary of significant accounting policies continued

3.23 Significant accounting judgments and estimates continued

Estimated Recoverable Reserves

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

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

Useful lives and depreciation rates for property, plant and equipment

Depreciation expense is allocated based on estimated property, plant and equipment useful lives and depreciation rates except the mineral properties are depreciated on unit-of production basis based on proven and probable reserves. Therefore, changes in the useful life or depreciation rates from the initial estimate could impact the carrying value of property, plant and equipment and an adjustment would be recognized in profit or loss.

4. Segmented information

The Company's one reportable operating segment is its Coal Division. The Company's Interim 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, and logistics and trading of coal in Mongolia and China. The Company's Corporate Division does not earn revenues and therefore does not meet the definition of an operating segment.

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

4. Segmented information continued

During the year ended December 31, 2017, the Coal Division had 20 active customers with the largest customer accounting for 25% of revenues, the second largest customer accounting for 19% of revenues, the third largest customer accounting for 11% of revenues, the fourth largest customer accounting for 10% of revenues and the other customers accounting for the remaining 35% of revenues.

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 December 31, 2017	$ **253,256**	$ **7,311**	$ **260,567**
As at December 31, 2016	257,256	2,065	259,321
Segment liabilities			
As at December 31, 2017	$ **119,095**	$ **130,932**	$ **250,027**
As at December 31, 2016	81,288	132,020	213,308
Segment loss			
For the year ended December 31, 2017	$ **(12,280)**	$ **(27,741)**	$ **(40,021)**
For the year ended December 31, 2016	(31,943)	(28,903)	(60,846)
Segment revenues			
For the year ended December 31, 2017	$ **120,973**	$ **–**	$ **120,973**
For the year ended December 31, 2016	58,450	–	58,450
Impairment charge on assets(ii)			
For the year ended December 31, 2017	$ **32,432**	$ **–**	$ **32,432**
For the year ended December 31, 2016	11,147	–	11,147
Depreciation and amortization			
For the year ended December 31, 2017	$ **46,142**	$ **273**	$ **46,415**
For the year ended December 31, 2016	46,132	185	46,317
Share of earnings of a joint venture			
For the year ended December 31, 2017	$ **1,287**	$ **–**	$ **1,287**
For the year ended December 31, 2016	806	–	806
Finance cost			
For the year ended December 31, 2017	$ **913**	$ **22,045**	$ **22,958**
For the year ended December 31, 2016	816	21,498	22,314
Finance income			
For the year ended December 31, 2017	$ **24**	$ **140**	$ **164**
For the year ended December 31, 2016	21	218	239
Current income tax charge			
For the year ended December 31, 2017	$ **1,740**	$ **–**	$ **1,740**
For the year ended December 31, 2016	1,470	–	1,470

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

(ii) The impairment charge on assets for the year ended December 31, 2017 relates to properties for resale (Note 15), inventories (Note 16), prepaid expenses and deposits (Note 17) and property, plant and equipment (Note 18). The impairment charge on assets for the year ended December 31, 2016 relates to trade and other receivables (Note 13), inventories (Note 16) and property, plant and equipment (Note 18).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

4. Segmented information continued

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

	Mongolia	Hong Kong	China	Consolidated Total
Revenue [i]				
For the year ended December 31, 2017	$ –	$ –	$ 120,973	$ 120,973
For the year ended December 31, 2016	–	–	58,450	58,450
Non-current assets				
As at December 31, 2017	$ 181,603	$ 467	$ 345	$ 182,415
As at December 31, 2016	201,153	599	392	202,144

(i) The revenue information above is based on the locations of the customers.

5. Revenue

Revenue represents the net invoiced value of goods sold which arises from the trading of coal.

6. Expenses by nature

The Company's loss before tax is arrived at after charging/(crediting):

	Year ended December 31, 2017	2016
Depreciation	$ 33,719	$ 38,511
Auditors' remuneration	430	422
Employee benefit expense (including directors' remuneration)		
Wages and salaries	$ 7,995	$ 6,729
Equity-settled share option expense (Note 28)	123	48
Pension scheme contributions	797	675
	$ 8,915	$ 7,452
Minimum lease payments under operating leases	$ 864	$ 890
Foreign exchange loss/(gain)	1,116	(5,423)
Impairment of property, plant and equipment (Note 18)	11,171	1,152
Impairment of coal stockpile inventories (Note 16)	17,026	7,354
Provision/(reversal of provision) for doubtful trade and other receivables (Note 13)	(682)	2,641
Penalty on late settlement of trade payables	280	–
Discounting on settlement of trade payables (Note 8)	–	(1,009)
Impairment of properties for resale (Note 15)	1,718	–
Impairment of prepaid expenses and deposit (Note 17)	2,517	–
Provision of commercial arbitration (Note 21)	2,384	–
Mining services, net (Note 8)	2,395	1,006
Settlement of civil claims	–	2,652
Underprovision of miscellaneous taxes (Note 8)	1,421	–
Mine operating costs and other	54,473	40,909
Total expenses	$ 137,747	$ 96,557

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

7. Cost of sales

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

	Year ended December 31, 2017	2016
Operating expenses	**$ 55,451**	$ 41,452
Share-based compensation expense/(recovery) (Note 28)	**30**	(8)
Depreciation and depletion	**20,719**	26,142
Impairment of coal stockpile inventories (Note 16)	**17,026**	7,354
Cost of sales from mine operations	**93,226**	74,940
Cost of sales related to idled mine assets (i)	**12,632**	12,105
Cost of sales	**$ 105,858**	$ 87,045

(i) Cost of sales related to idled mine assets for the year ended December 31, 2017 includes $12,632 of depreciation expense (2016: includes $12,105 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 year ended December 31, 2017 totaled $77,383 (2016: $62,931).

8. Other operating expenses

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

	Year ended December 31, 2017	2016
Mining services, net	**$ (2,395)**	$ (1,006)
Provision of commercial arbitration (Note 21)	**(2,384)**	–
Impairment of properties for resale (Note 15)	**(1,718)**	–
Impairment of prepaid expenses and deposits (Note 17)	**(2,517)**	–
Underprovision of miscellaneous taxes	**(1,421)**	–
Foreign exchange gain/(loss)	**(1,116)**	5,423
Reversal of provision/(provision) for doubtful trade and other receivables (Note 13)	**682**	(2,641)
Discount on settlement of trade payables	**–**	1,009
Settlement of civil claims (Note 20)	**–**	(2,652)
Others	**(395)**	(183)
Other operating expenses	**$ (11,264)**	$ (50)

9. Administration expenses

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

	Year ended December 31, 2017	2016
Corporate administration	**$ 2,534**	$ 2,724
Legal and professional fees	**2,464**	2,022
Salaries and benefits	**3,726**	2,820
Share-based compensation expense (Note 28)	**89**	58
Depreciation	**368**	264
Administration expenses	**$ 9,181**	$ 7,888

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

10. Finance costs and income

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

	Year ended December 31, 2017	2016
Interest expense on convertible debenture (Note 25)	$ **21,315**	$ 21,279
Interest expense on borrowings (Note 24)	**1,103**	781
Finance costs on notes receivables (Note 14)	**290**	–
Loan arrangement fee (Note 24)	**90**	159
Accretion of decommissioning liability (Note 26)	**160**	95
Finance costs	$ **22,958**	$ 22,314

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

	Year ended December 31, 2017	2016
Unrealized gain on embedded derivatives in convertible debenture (Note 25)	$ **137**	$ 217
Interest income	**27**	22
Finance income	$ **164**	$ 239

11. Taxes

11.1 Income tax recognized in profit or loss

The Canadian statutory tax rate was 26% (2016: 26%). A reconciliation between the Company's tax expense and the product of the Company's loss before tax multiplied by the Company's domestic tax rate is as follows:

	Year ended December 31, 2017	2016
Loss before tax	$ **(38,281)**	$ (59,376)
Statutory tax rate	**26%**	26%
Income tax recovery based on combined Canadian federal and provincial statutory rates	**(9,953)**	(15,438)
Lower effective tax rate in foreign jurisdictions	**290**	610
Tax effect of tax losses and temporary differences not recognized	**7,221**	6,529
Tax loss utilzed	**(12,164)**	–
Profits or losses attributable to joint venture	**322**	204
Non-deductible expenses	**16,024**	9,565
Income tax expenses	$ **1,740**	$ 1,470

11.2 Deferred tax balances

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

	As at December 31, 2017	2016
Tax loss carryforwards	$ **15,568**	$ 15,339
Property, plant and equipment and other assets	**(15,568)**	(15,339)
Total deferred tax balances	$ **–**	$ –

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

11. Taxes continued

11.3 Unrecognized deductible temporary differences and unused tax losses

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

	As at December 31, 2017	2016
Non-capital losses	**$ 166,274**	$ 141,480
Capital losses	**30,049**	30,049
Foreign exchange and others	**392,573**	376,531
Total unrecognized amounts	**$ 588,896**	$ 548,060

11.4 Expiry dates

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

	As at December 31, 2017 U.S. Dollar Equivalent	Expiry dates
Non-capital losses		
Canada	**$ 163,914**	2035 – 2037
Mongolia	**54**	2020
China	**2,306**	2022
	$ 166,274	
Capital losses		
Canada	**$ 30,049**	indefinite

12. Loss per share

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

	Year ended December 31, 2017	2016
Net loss	**$ (40,021)**	$ (60,846)
Weighted average number of shares	**272,188**	257,692
Basic and diluted loss per share	**$ (0.15)**	$ (0.24)

Potentially dilutive items not included in the calculation of diluted loss per share for the year ended December 31, 2017 include the convertible debenture (Note 25) and stock options (Note 28) that were anti-dilutive.

13. Trade and other receivables

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

	As at December 31, 2017	2016
Trade receivables	**$ 12,901**	$ 17,774
Other receivables	**3,585**	1,660
Total trade and other receivables	**$ 16,486**	$ 19,434

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

13. Trade and other receivables continued

The aging of the Company's trade and other receivables, based on invoice date and net of provisions, is as follows:

	As at December 31, 2017	2016
Less than 1 month	$ **15,962**	$ 5,777
1 to 3 months	**296**	5,622
3 to 6 months	**19**	7,937
Over 6 months	**209**	98
Total trade and other receivables	$ **16,486**	$ 19,434

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.

During the year ended December 31, 2016, the Company entered into a settlement agreement with one of its major customers (the "Customer") pursuant to which 200 residential units and 40 parking spaces (collectively, the "240 Units") located in Ulaanbaatar, Mongolia, were transferred to the Company as partial consideration for settling an outstanding trade receivables in the amount of $12,000 owing by the Customer to the Company, with the balance of the receivable, totaling $7,500, payable in cash by the Customer to the Company by March 31, 2017 (subsequently extended to June 30, 2017). In August 2017, the entirety of the $7,500 balance has been repaid by, and collected from, the Customer.

As the transfers of title to the 240 Units were substantially completed during the first quarter of 2017, the 240 Units have been recorded at $10,622, net of impairment, in the Company's accounts accordingly (Note 15). The settlement agreement included an option for the Company to return any unsold units back to the Customer, until September 30, 2017, at the original price per unit in exchange for an immediate payment of the balance in cash. The Company did not elect to exercise the option.

For the year ended December 31, 2017, the Company recorded a reversal of provision of $682 on its trade and other receivables in other operating expenses as a result of collecting certain long aged receivables (2016: provision of $2,641). 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.

14. Notes receivables

Notes receivables are financial instruments in Chinese banking system. As at December 31, 2017, bank notes receivables of $1,898 are readily convertible into cash or can be utilized as settlement of outstanding payables while commercial notes receivables of $10,622 with maturity within 6 months are recorded. Finance costs of $290 was recorded for the commercial notes receivables.

15. Properties for resale

Properties for resale are stated at the lower of cost and net realizable value. Cost is determined by apportionment of total development cost or consideration, attributable to the unsold units. Net realizable value is determined on the basis of anticipated sales proceeds, or estimated by management based on the prevailing market conditions, less all estimated costs to completion and selling expenses, on an individual property basis.

For the year ended December 31, 2017, the Company recorded an impairment of $1,718 on the unsold units of properties held for sale (2016: nil).

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

16. Inventories

The Company's inventories consist of the following amounts:

	As at December 31, 2017	2016
Coal stockpiles	**$ 18,223**	$ 7,228
Materials and supplies	**18,166**	21,355
Total inventories	**$ 36,389**	$ 28,583

Cost of sales for the year ended December 31, 2017 includes an impairment loss of $17,026 related to the Company's coal stockpile inventories (2016: $7,354). As at December 31, 2017, $13,500 of the Company's coal stockpile inventories are carried at their net realizable value (2016: $321).

17. Prepaid expenses and deposits

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

	As at December 31, 2017	2016
Vendor prepayments	**$ 2,153**	$ 4,102
Restricted cash balance	**1**	1
Other prepaid expenses and deposits	**4,132**	4,091
Total prepaid expenses and deposits	**$ 6,286**	$ 8,194

For the year ended December 31, 2017, the Company recorded an impairment of $2,517 on the vendor prepayments (2016: nil).

18. 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	Non-depreciable assets	Total
Cost						
As at January 1, 2017	$ 346,299	$ 28,755	$ 72,194	$ 148,938	$ 28,564	$ 624,750
Additions	**4,404**	**119**	**–**	**24,463**	**403**	**29,389**
Disposals	**(163)**	**–**	**–**	**–**	**–**	**(163)**
As at December 31, 2017	**$ 350,540**	**$ 28,874**	**$ 72,194**	**$ 173,401**	**$ 28,967**	**$ 653,976**
Accumulated depreciation and impairment charges						
As at January 1, 2017	$ (260,518)	$ (27,655)	$ (46,759)	$ (95,991)	$ (13,018)	$ (443,941)
Depreciation for the year	**(36,754)**	**(671)**	**(4,684)**	**(4,306)**	**–**	**(46,415)**
Eliminated on disposals	**8**	**–**	**–**	**–**	**–**	**8**
Impairment charge	**–**	**–**	**–**	**–**	**(11,171)**	**(11,171)**
As at December 31, 2017	**$ (297,264)**	**$ (28,326)**	**$ (51,443)**	**$ (100,297)**	**$ (24,189)**	**$ (501,519)**
Carrying amount						
As at December 31, 2016	$ 85,781	$ 1,100	$ 25,435	$ 52,947	$ 15,546	$ 180,809
As at December 31, 2017	**$ 53,276**	**$ 548**	**$ 20,751**	**$ 73,104**	**$ 4,778**	**$ 152,457**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

18. Property, plant and equipment continued

	Mobile equipment	Other operating equipment	Buildings and roads	Mineral properties	Non-depreciable assets	Total
Cost						
As at January 1, 2016	$ 344,832	$ 28,534	$ 72,194	$ 145,270	$ 28,564	$ 619,394
Additions	**1,780**	**345**	**–**	**3,668**	**–**	**5,793**
Disposals	**(313)**	**(124)**	**–**	**–**	**–**	**(437)**
As at December 31, 2016	**$ 346,299**	**$ 28,755**	**$ 72,194**	**$ 148,938**	**$ 28,564**	**$ 624,750**
Accumulated depreciation and impairment charges						
As at January 1, 2016	$ (222,482)	$ (26,772)	$ (42,056)	$ (93,733)	$ (11,866)	$ (396,909)
Depreciation for the year	**(38,349)**	**(1,007)**	**(4,703)**	**(2,258)**	**–**	**(46,317)**
Eliminated on disposals	**313**	**124**	**–**	**–**	**–**	**437**
Impairment charges	**–**	**–**	**–**	**–**	**(1,152)**	**(1,152)**
As at December 31, 2016	**$ (260,518)**	**$ (27,655)**	**$ (46,759)**	**$ (95,991)**	**$ (13,018)**	**$ (443,941)**
Carrying amount						
As at December 31, 2015	$ 122,350	$ 1,762	$ 30,138	$ 51,537	$ 16,698	$ 222,485
As at December 31, 2016	**$ 85,781**	**$ 1,100**	**$ 25,435**	**$ 52,947**	**$ 15,546**	**$ 180,809**

18.1 Non-depreciable assets

The non-depreciable assets include the construction in progress and deposits on purchasing items of property, plant and equipment of $4,169 (2016: $15,340), which 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.

18.2 Pledge on items of property, plant and equipment

As at December 31, 2017, certain of the Company's property, plant and equipment of $4,539 (2016: $3,678) were pledged as security for a bank loan granted to the Company (Note 24).

18.3 Items of property, plant and equipment held under finance leases

As at December 31, 2017, certain of the Company's mobile equipment of $672 (2016: $720) were held under finance leases.

18.4 Impairment charges

For the year ended December 31, 2017, the Company recorded an impairment charges of $11,171 (2016: $1,152) in respect of the non-depreciable assets.

19. Investment in a joint venture

The Company's investment consists of the following amounts:

	As at December 31, 2017	2016
Non-current investment in joint venture		
Investment in RDCC LLC	**$ 21,052**	$ 21,335
Total investment	**$ 21,052**	$ 21,335

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

19. Investment in a joint venture continued

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.

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

	Year ended December 31, 2017	2016
Balance, beginning of period	**$ 21,335**	$ 25,667
Dividend received	**(1,991)**	(1,255)
Share of earnings of a joint venture	**1,287**	806
Share of other comprehensive income/(loss) of a joint venture	**421**	(3,883)
Balance, end of period	**$ 21,052**	$ 21,335

Summarized financial statement information of RDCC LLC is as follows (presented on a 100% basis of RDCC LLC in which the Company has a 40% investment):

	As at December 31, 2017	2016
Current assets	**$ 830**	$ 592
Non-current assets	**38,610**	38,842
Total assets	**$ 39,440**	$ 39,434
Current liabilities	**$ 827**	$ 400
Total liabilities	**$ 827**	$ 400

	Year ended December 31, 2017	2016
Revenue	**$ 6,050**	$ 5,007
Gross profit margin	**3,717**	2,575
Other operating and finance costs	**(197)**	(261)
Profit before tax	**3,520**	2,314
Net profit	**$ 3,217**	$ 2,016
Other comprehensive income/(loss)	**$ 1,053**	$ (9,708)
Total comprehensive income/(loss)	**$ 4,270**	$ (7,692)

20. Trade and other payables

Trade and other payables of the Company primarily consist 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.

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

20. Trade and other payables continued

The aging of the Company's trade and other payables, based on invoice date, was as follows:

	As at December 31, 2017	2016
Less than 1 month	**$ 20,664**	$ 14,640
1 to 3 months	**16,132**	2,493
3 to 6 months	**8,825**	2,648
Over 6 months	**33,598**	23,847
Total trade and other payables	**$ 79,219**	$ 43,628

20.1 Settlement of Lawsuit Notice from a Former Fuel Supplier

On June 30, 2017, the Company signed the Triparty Settlement Agreement with Magnai Trade LLC ("MTLLC"), a former fuel supplier of SGS and ICIC LLC ("ICIC") (an independent fuel supplier of the Company), pursuant to which: (i) MTLLC transferred to ICIC its right to receive payment from the Company of $8,047 (the "Outstanding Amount") owing under the settlement agreement dated February 10, 2017 between the Company and MTLLC and its right to enforce the arbitration award against the Company in connection therewith; and (ii) the Company and ICIC agreed to a revised payment schedule for repayment of the Outstanding Amount. Pursuant to the Triparty Settlement Agreement, the Company will pay interest on the Outstanding Amount, which shall accrue at a monthly rate of 1.8% and will be settled on a monthly basis. The Company was required to repay on average $1,281 monthly during the period from July 2017 to November 2017 pursuant to the Triparty Settlement Agreement.

As of the date hereof, the Company has fulfilled its obligations under the Triparty Settlement Agreement and has fully repaid the Outstanding Amount.

21. Provision for commercial arbitration

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.

21. Provision for commercial arbitration continued

On January 10, 2018, the Company received a confidential partial award (final except as to costs) with respect to the commercial arbitration. Pursuant to the Arbitration Award, SGS has been ordered to repay the sum of $11,500 (which SGS had received as a prepayment for the purchase of coal) to First Concept, together with accrued interest at a simple interest rate of 6% per annum from the date which the prepayment was made until the date of the Arbitration Award, and then at a simple interest rate of 8% per annum until full payment. The Arbitration Award is final, except as to costs which have been reserved for a future award. As at December 31, 2017, the Company has recorded a provision of $13,884 for the commercial arbitration. (2016: nil, during which the $11,500 in relation to First Concept was recorded in deferred revenue).

On March 23, 2018, SGS received a notice from First Concept demanding payment of the full amount of the Arbitration Award, together with the accrued interest thereon, by no later than March 30, 2018, otherwise First Concept intends to commence enforcement proceedings against SGS in respect of the Arbitration Award. The Company is currently considering and reviewing its options with respect to the Arbitration Award, including exploring ways to work with First Concept on payment arrangements that are practical to and are in best interests of both parties; however, there can be no assurance that a favorable outcome will be reached. In any event, if SGS fails to satisfy the Arbitration Award, First Concept may apply to enforce the Arbitration Award against SGS through judicial measures in courts of Mongolia or in other applicable jurisdiction(s). In the event that First Concept applies to enforce the Arbitration Award against SGS through judicial measures in courts of Mongolia or in other applicable jurisdiction(s), the Company intends to defend itself against such enforcement proceedings through independent litigation counsel retained by the Company for this purpose. However, due to the inherent uncertainties of litigation, it is not possible to predict whether the Company will be successful in defending itself against any such enforcement proceedings.

If First Concept is successful in enforcing the Arbitration Award against SGS, the Company may not be able to re-pay the sum of $11,500 and the associated interest. In such case, this will represent another event of default under the CIC Convertible Debenture and CIC would have another basis 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 and associated interest to First Concept could result in voluntary or involuntary proceedings involving the Company (including bankruptcy).

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22. Provision for court case penalty

In May 2016, the Resolution 258 was issued by the Government of Mongolia, which approved the Company's proposal to partially settle a prior written verdict of the Mongolian Second District Criminal Court which declared SGS to be financially liable as a "civil defendant" for a penalty (the "Tax Penalty") of MNT 35.3 billion (approximately $18,200 on February 1, 2015) by way of certain cash payments in 2016 and 2017 and by the Company performing certain mining operations at the Tavan Tolgoi deposit on behalf of Erdenes.

In compliance with Resolution 258, in November 2016, the Company entered into an agreement with Erdenes under which the Company agreed to perform certain mining operations equivalent to MNT 20.3 billion (approximately $8,135) in the West Tsankhi section of the Tavan Tolgoi deposit during the period from November 2016 to February 2017. In February 2017, the Company completed mining operations at the Tavan Tolgoi deposit equivalent to MNT 20.3 billion (approximately $8,135) as set out in the agreement with Erdenes.

On January 10, 2018, SGS was informed by the Court Decision Implementation Agency of Capital City in Mongolia that the enforcement procedure in relation to the Tax Verdict has been terminated and no party shall have any right to make any further claims in connection with the Tax Verdict. As of the date hereof, SGS has fulfilled its obligations under the previously disclosed judgment of the Second District First Instance Criminal Court of Mongolia (the "Tax Verdict") rendered against SGS in January 2015.

The decrease from the initial $18,200 owing as at February 1, 2015 is as a result of transfers from frozen bank accounts of $1,200, additional cash payments by the Company of $5,473, the provision of mining services at the Tavan Tolgoi deposit of $8,135 and the foreign exchange adjustments.

23. Deferred revenue

At December 31, 2017, the Company has deferred revenue of $27,644, which represents cash prepayments for coal sales from customers (2016: $29,849).

Included in deferred revenue as at December 31, 2016 was amount prepaid by First Concept, who served a notice of arbitration (the "Notice") on SGS of $11,500, details are further disclosed in Note 21.

24. Interest-bearing borrowings

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

	As at December 31, 2017	2016
Turquoise Hill Loan Facility (i)	**$ 1,708**	$ 2,881
Equipment loan (ii)	**2,441**	–
Bank loan (iii)	**3,041**	2,026
Finance leases payable (iv)	**503**	547
Short-term bridge loan (v)	**–**	3,425
Total interest-bearing borrowings	**$ 7,693**	$ 8,879

24. Interest-bearing borrowings continued

(i) Turquoise Hill Loan Facility

On May 25, 2014, the Company announced it 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 as described below); 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 2016, the due date of the TRQ Loan, was extended several times and the maximum amount of the facility was reduced to $3,800.

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

- The Company agreed to effect monthly repayments on the last business day of each month in an amount of (i) $150 per month from May 2016 to April 2017; (ii) $200 per month from May 2017 to December 2017; and (iii) the remaining balance on December 29, 2017 (the payments in (i) and (iii), the "Repayments"); and
- Interest shall continue to accrue on all outstanding obligations at the 12-month US dollar LIBOR rate.

As of the date hereof, the Company has not paid its September, October, November and December 2017 monthly payments and the accrued interest. Pursuant to the terms of the TRQ Loan and the May 2016 Deferral Agreement, the Company is, as of the date hereof, in default of its obligations under the TRQ Loan and the May 2016 Deferral Agreement as a result of the Company failing to make the Repayments in its entirety on or before the dates set out above. Consequently, all of the outstanding obligations under the TRQ Loan and the May 2016 Deferral Agreement are immediately due and payable to Turquoise Hill as of the date hereof. As of the date hereof, the Company has received no indication from Turquoise Hill of any intention to demand payment of the amounts outstanding under the TRQ Loan and the May 2016 Deferral Agreement.

As at December 31, 2017, the outstanding principal and accrued interest under this facility amounted to $1,000 and $708, respectively (at December 31, 2016, the outstanding principal and accrued interest under this facility amounted to $2,200 and $681, respectively).

(ii) Equipment Loan

Inner Mongolia SouthGobi Energy Ltd., a subsidiary of the Company executed a $10,369 loan agreement on August 31, 2017 with Beijing Jin Rui Tian Chen Asset Management Co Ltd. for the purpose of financing the purchase of mining equipment to increase the production capacity of the Company.

The key terms of the equipment loan are as follows:

- Principal amount of $10,369;
- Maturity date set at 12 months from each drawdown;
- Interest rate of 12% per annum and payable upon maturity; and
- The Company was to have provided a corporate guarantee to cover the principal and interest owed and certain items of property, plant and equipment were to have been pledged as security upon the completion of equipment purchase.

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

24. Interest-bearing borrowings continued

(ii) Equipment Loan continued

As at December 31, 2017, the outstanding principal and accrued interest for the equipment loan amounted to $2,309 and $132, respectively (December 31, 2016: nil).

A loan arrangement fee of 1% of the loan principal drawn was charged and will be amortized throughout the loan term. For the year ended December 31, 2017, $8 of loan arrangement fee was amortized (2016: nil). The Company believes the principal amount is capped at the amount drawn down to date and the related mining equipment has not been purchased as of the date hereof.

(iii) Bank Loan

On May 6, 2016, SGS obtained a bank loan (the "Bank Loan") in the principal amount of $2,000 from a Mongolian bank (the "Bank"). The principal terms of the Bank Loan include, among other things, an interest rate of 15.8% per annum, a maturity date of May 6, 2017 (subsequently extended as described below) and SGS being required to pledge certain of its mobile equipment in favour of the Bank as collateral for the Bank Loan.

On July 6, 2017, the Company and the Bank entered into a supplementary agreement with the key commercial terms of the Bank Loan modified as follows:

- Principal amount increased to $3,000;
- $2,300 of the principal amount will mature on May 6, 2018 while the remaining balance of the principal amount of $700 will mature on January 4, 2019;
- Interest rate of 15.8% per annum applies to the $2,300 portion of the principal amount, while an interest rate of 15.0% per annum applies to the remaining $700 portion of the principal amount; in each case, interest is payable monthly; and
- Certain items of property, plant and equipment with value of $4,539 as at December 31, 2017 were pledged as security.

As at December 31, 2017, the outstanding balance for the Bank Loan was $3,000 (December 31, 2016: $2,000) and the Company owed accrued interest of $41 (December 31, 2016: $26).

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

24. Interest-bearing borrowings continued

(iv) Finance Leases Payable

The Company leases certain of its mobile equipment for daily operations. These leases are classified as finance leases and have remaining lease terms ranging from 2 to 5 years.

At December 31, 2017, the total future minimum lease payments under finance leases and their present values were as follows:

	Minimum lease payments As at		Present value of minimum lease payments As at	
	December 31, 2017	December 31, 2016	**December 31, 2017**	December 31, 2016
Amounts payable:				
Within one year	**$ 192**	$ 152	**$ 162**	$ 122
In the second year	**174**	152	**160**	131
In the third to fifth years, inclusive	**188**	314	**181**	294
Total minimum finance lease payments	**$ 554**	$ 618	**$ 503**	$ 547
Future finance charges	**(51)**	(71)		
Total net lease finance payables	**$ 503**	$ 547		
Portion classified as current liabilities	**(162)**	(122)		
Non-current portion	**$ 341**	$ 425		

(v) 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 bridge loan accrues interest at a rate of 8% per annum with interest payable upon the repayment of loan principal.

The Company repaid the first tranche of the short-term bridge loan with interest of $5,042 up to August 11, 2016. During June and July 2016, the Company drew the second tranche of $5,038, of which $1,504 was to mature in March 2017 and $3,534 was to mature in April 2017. In December 2016, $1,454 was repaid for the short-term bridge loan and a further $1,818 and $1,592 was subsequently repaid in January 2017 and March 2017, respectively and the loan principal was fully settled. The outstanding interest was settled in April 2017.

A loan arrangement fee of 5% of the loan principal drawn was charged, totaling $252 for the loans drawn during June and July 2016 and amortized throughout the loan term. For the year ended December 31, 2017, $82 of loan arrangement fee was amortized (2016: $159).

25. Convertible debenture

25.1 Key commercial terms

On November 19, 2009, the Company issued a convertible debenture to a wholly owned subsidiary of CIC for $500,000. The convertible debenture bears interest at 8.0% per annum (6.4% payable semi-annually in cash and 1.6% payable annually in the Company's shares) and has a maximum term of 30 years. The convertible debenture is secured by a first ranking charge over the Company's assets, including shares of its material subsidiaries. During 2010, the Company exercised a right within the debenture to call and convert $250,000 of the debenture for 21,471 common shares. Following the conversion the outstanding principal balance was $250,000 and has remained unchanged at that balance to December 31, 2017.

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

25. Convertible debenture continued

25.1 Key commercial terms continued

The key commercial terms of the financing include:

- Interest – 8% per annum (6.4% payable semi-annually in cash and 1.6% payable annually in the Company's common shares, where the number of shares to be issued is calculated based on the 50-day volume-weighted average price ("VWAP")).
- Term – Maximum of 30 years.
- Security – First charge over the Company's assets, including shares of its material subsidiaries.
- Conversion price – The conversion price is set as the lower of CAD$11.88 or the 50-day VWAP at the date of conversion, with a floor price of CAD$8.88 per share.
- CIC's conversion right – CIC has the right to convert the convertible debenture, in whole or in part, into common shares twelve months after the date of issue.
- Company's normal conversion right – After sixty months from the issuance date, and when the conversion price is greater than CAD$10.66, the Company is entitled to force conversion of the outstanding convertible debenture, in whole or in part, into common shares at the conversion price.
- Representation on the Company's Board – While the convertible debenture is outstanding, or while CIC has a minimum 15% direct or indirect stake in the Company, CIC has the right to nominate one director to the Company's Board of Directors. The Company currently has seven Board of Directors members of which one (Mr. Wen Yao) was nominated by CIC.
- Voting restriction – CIC has agreed that it will not have any voting rights in the Company beyond 29.9% if CIC ever acquires ownership of such a shareholder stake.
- Pre-emption rights – While the convertible debenture is outstanding, or while CIC has a 15% direct or indirect stake in the Company, CIC has certain pre-emption rights on a pro-rata basis to subscribe for any new shares to be allotted and issued by the Company for the period which the convertible debenture is outstanding. The pre-emption rights will not apply to new shares issued pursuant to pro-rata public equity offerings made to all shareholders, exercise of stock options and shares issued to achieve a 25% public float.
- Right of first offer – While a portion of the convertible debenture is outstanding, or while CIC has a 15% direct or indirect stake in the Company, CIC has the right of first offer for any direct and indirect sale of Turquoise Hill's ownership stake in the Company.
- Registration rights – CIC has registration rights under applicable Canadian provincial securities laws in connection with the common shares issuable upon conversion of the convertible debenture.

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

25. Convertible debenture continued

25.2 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.

25.3 Valuation assumptions

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

	As at December 31,	
	2017	2016
Floor conversion price	**CAD$8.88**	CAD$8.88
Ceiling conversion price	**CAD$11.88**	CAD$11.88
Common share price	**CAD$0.18**	CAD$0.27
Historical volatility	**82%**	79%
Risk free rate of return	**2.22%**	2.23%
Foreign exchange spot rate (CAD$ to U.S. Dollar)	**0.80**	0.74
Forward foreign exchange rate curve (CAD$ to U.S. Dollar)	**0.795 – 0.802**	0.74 – 0.77

25.4 Presentation

Based on the Company's valuation as at December 31, 2017, the fair value of the embedded derivatives decreased by $137 compared to December 31, 2016. The decrease was recorded as finance income for the year ended December 31, 2017.

For the year ended December 31, 2017, the Company recorded interest expense of $21,315 related to the convertible debenture as a finance cost (2016: $21,279). 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%.

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

25. Convertible debenture continued

25.4 Presentation continued

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

	Year ended December 31, 2017	2016
Balance, beginning of year	$ 117,590	$ 108,659
Interest expense on convertible debenture	21,315	21,279
Decrease in fair value of embedded derivatives	(137)	(217)
Interest paid	(22,394)	(12,131)
Balance, end of year	$ 116,374	$ 117,590

The convertible debenture balance consists of the following amounts:

	As at December 31, 2017	2016
Current convertible debenture		
Interest payable	$ 24,242	$ 25,597
Debt host	91,730	–
Fair value of embedded derivatives	402	–
	116,374	25,597
Non-current convertible debenture		
Debt host	–	91,453
Fair value of embedded derivatives	–	540
	–	91,993
Total convertible debenture	$ 116,374	$ 117,590

25.5 Interest deferral and settlement

On June 12, 2017, the Company executed the June 2017 Deferral Agreement with CIC for a revised repayment schedule on the $22,254 of cash interest and associated costs originally due on May 19, 2017 (the “May 2017 Interest Payable”). The key repayment terms of the June 2017 Deferral Agreement are: (i) the Company was required to repay on average $2,170 of the cash interest and associated costs monthly during the period from May 2017 to October 2017; and (ii) the Company was required to repay $9,731 of cash interest and associated costs on November 19, 2017. The Company will pay a deferral fee at a rate of 6.4% per annum in consideration for the deferral.

At any time before the May 2017 Interest Payable is fully repaid, the Company is required to consult with and obtain written consent from CIC prior to effecting a replacement or termination of either or both of its Chief Executive Officer and its Chief Financial Officer, otherwise this will constitute an event of default under the CIC Convertible Debenture, but CIC shall not withhold its consent if the Board proposes to replace either or both such officers with nominees selected by the Board, provided that the Board acted honestly and in good faith with a view to the best interests of the Company in the selection of the applicable replacements.

In addition, pursuant to the terms of the CIC Convertible Debenture, the Company was required to pay $8,066 of anniversary cash interest to CIC on November 19, 2017. Pursuant to the Convertible Debenture, the Company was also obliged to issue $4,000 worth of November 2017 PIK Interest shares to CIC on November 19, 2017.

25. Convertible debenture continued

25.5 Interest deferral and settlement continued

As of the date hereof, the Company: (i) has neither paid the November 19th Payments nor issued the November 2017 PIK Interest shares to CIC within the cure period provided for in the CIC Convertible Debenture; and (ii) has not agreed upon a repayment plan for such amounts with CIC. Consequently, the Company is in default under the CIC Convertible Debenture and the June 2017 Deferral Agreement. Pursuant to the terms of the CIC Convertible Debenture and the June 2017 Deferral Agreement, CIC may, in its discretion, provide notice to the Company and declare all principal, interest and other amounts owing under the CIC Convertible Debenture and the June 2017 Deferral Agreement immediately due and payable, and take steps to enforce payment thereof, which would have a material adverse effect on the business and operations of the Company and may negatively affect the price and volatility of the Common Shares and any investment in such shares could suffer a significant decline or total loss in value. As of the date hereof, the Company has received no indication from CIC of any intention to deliver a notice of default under the CIC Convertible Debenture and the June 2017 Deferral Agreement or to accelerate the amounts outstanding under the CIC Convertible Debenture and the June 2017 Deferral Agreement.

The Company is in discussions with CIC for a deferral of the November 19th Payments and the November 2017 PIK Interest; however, there can be no assurance that a favorable outcome will be reached. As part of these discussions, CIC has notified the Company that, as a condition to agreeing to any deferral, it requires that the mutual co-operating agreement (the “Co-Operation Agreement”) dated November 19, 2009 between the Company and CIC be amended to revise the manner in which the amount of the service fee payable to CIC under the Co-Operation Agreement is calculated with retroactive effect; however, the Company has not entered into any formal agreement in respect of the Co-Operation Agreement as of the date hereof. In addition, CIC has advised the Company that it is undertaking a review of the financial and operational performance of the Company. To the knowledge of the Company, this review remains on-going as of the date hereof.

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.

As a consequence of the Company not entering into a deferral agreement with CIC as at December 31, 2017, IAS 1 requires the Company to classify the entire balance of the CIC Convertible Debenture as a current liability as at December 31, 2017, notwithstanding the fact that CIC has not indicated any intention to deliver notice of default or accelerate the maturity of the debenture. The Company anticipates that both the debt host and the fair value of the embedded derivative will be classified as a non-current liability upon the execution of a deferral agreement, unless a future event of default occurs under the terms of the CIC Convertible Debenture.

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26. Decommissioning liability

At December 31, 2017, the decommissioning liability primarily relates to reclamation and closure costs of the Company's Ovoot Tolgoi Mine.

The Ovoot Tolgoi Mine decommissioning liability is calculated as the net present value of the estimated future reclamation and closure costs, which at December 31, 2017 totaled $8,575 (2016: $7,271). The estimated future reclamation and closure costs are inflated using an estimated inflation rate of 1.8% (2016: 1.9%) and discounted at 8.4% per annum (2016: 8.4% per annum) to determine the year end decommissioning liability. The settlement of the decommissioning liability will occur through to 2030.

The movement in the decommissioning liability during the years ended December 31, 2017 and 2016 were as follows:

	Year ended December 31, 2017	2016
Balance, beginning of year	**$ 4,288**	$ 3,149
Adjustments	**765**	1,044
Accretion	**160**	95
Balance, end of year	**$ 5,213**	$ 4,288

27. Equity

27.1 Share capital

The Company has authorized an unlimited number of common and preferred shares with no par value. At December 31, 2017, the Company had 272,607 common shares outstanding (2016: 257,698) and no preferred shares outstanding (2016: nil).

On January 11, 2017, 14,892 common shares were issued by the Company to settle the $4,000 November 19, 2016 share interest payment.

27.2 Accumulated deficit and dividends

At December 31, 2017, the Company has accumulated a deficit of $1,135,809 (2016: $1,095,788). No dividend has been paid or declared by the Company since inception.

The Board did not recommend the payment of any final dividend for the year ended December 31, 2017 (2016: nil).

28. Share-based payments

28.1 Stock option plan

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

For the year ended December 31, 2017, the Company granted 750 stock options (2016: 750) to officers, employees, directors and other eligible persons at exercise prices ranging from CAD$0.33 to CAD$0.39 (2016: exercise prices ranging from CAD$0.25 to CAD$0.33) and expiry dates ranging from June 5, 2022 to June 30, 2022 (2016: expiry dates ranging from August 26, 2021 to November 16, 2021). The weighted average fair value of the options granted in the year ended December 31, 2017 was estimated at $0.08 (CAD$0.11) (2016: $0.09, CAD$0.12) per option at the grant date using the Black-Scholes option pricing model.

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

28. Share-based payments continued

28.1 Stock option plan continued

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

	Year ended December 31, 2017	2016
Risk free interest rate	**1.36%**	0.94%
Expected life	**3 years**	3.2 years
Expected volatility[(i)]	**45%**	59%
Expected dividend per share	**$ nil**	$ nil

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

A share-based compensation expense of $55 for the options granted in the year ended December 31, 2017 (2016: $53) will be amortized over the vesting period, of which $28 was recognized in the year ended December 31, 2017 (2016: $7).

The total share-based compensation expenses for the year ended December 31, 2017 was $123 (2016: $48). Share-based compensation expense of $89 (2016: $58) has been allocated to administration expenses, share-based compensation expense of $4 (2016: share-based compensation recovery of $2) has been allocated to evaluation and exploration expenses and share-based compensation expense of $30 (2016: share-based compensation recovery of $8) has been allocated to cost of sales.

28.2 Outstanding stock options

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

	Year ended December 31, 2017 Number of options	Year ended December 31, 2017 Weighted average exercise price (CAD$)	Year ended December 31, 2016 Number of options	Year ended December 31, 2016 Weighted average exercise price (CAD$)
Balance, beginning of year	**1,910**	**$ 0.61**	2,399	$ 1.43
Options granted	**750**	**0.34**	750	0.32
Options exercised	**–**	**–**	–	–
Options forfeited	**(3)**	**0.92**	(324)	0.84
Options expired	**(367)**	**1.57**	(915)	2.44
Balance, end of year	**2,290**	**$ 0.36**	1,910	$ 0.61

The stock options outstanding and exercisable as at December 31, 2017 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)
$0.25 – $0.58	**2,124**	**$ 0.32**	**3.80**	**1,124**	**$ 0.31**	**2.37**
$0.65 – $0.92	**166**	**0.91**	**2.20**	**113**	**0.90**	**2.17**
	2,290	**$ 0.36**	**3.68**	**1,237**	**$ 0.36**	**2.35**

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

29. Reserves

29.1 Share option reserve

The Company's share option reserve relates to stock options granted by the Company to officers, employees, directors and other eligible persons under its stock option plan. Details about the Company's share-based payments are further disclosed in Note 28.

The share option reserve transactions for the years ended December 31, 2017 and 2016 are as follows:

	Year ended December 31,	
	2017	2016
Balance, beginning of year	**$ 52,340**	$ 52,292
Share-based compensation charged to operations	**123**	48
Balance, end of year	**$ 52,463**	$ 52,340

30. Capital risk management

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

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

At December 31, 2017, the Company's capital structure consists of convertible debt (Note 25), interest-bearing borrowings (Note 24) and the equity of the Company (Note 27). The Company is not subject to any externally imposed capital requirements. In order to maximize ongoing development efforts, the Company does not pay dividends.

For the year ended December 31, 2017, there were no significant changes in the processes used by the Company or in the Company's objectives and policies for managing its capital. As at December 31, 2017, the Company had cash of $6,471.

Based on the Company's forecasts for the year ending December 31, 2018, the Company is unlikely to have sufficient capital resources and does not expect to generate sufficient cash flows from mining operations in order to satisfy its ongoing obligations and future contractual commitments, including cash interest payments due on the CIC Convertible Debenture, the TRQ Loan, the equipment loan and the bank loan. Therefore, the Company is actively seeking additional sources of financing to continue operating and meet its objectives (Note 1).

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

31. Financial instruments and fair value measurements

31.1 Categories of financial instruments

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

	As at December 31, 2017	2016
Financial assets		
Fair value through profit or loss		
Notes receivables (Note 14)	**$ 12,520**	$ –
Loans-and-receivables		
Cash	**6,471**	966
Trade and other receivables (Note 13)	**16,486**	19,434
Total financial assets	**$ 35,477**	$ 20,400
Financial liabilities		
Fair value through profit or loss		
Convertible debenture – embedded derivatives (Note 25)	**$ 402**	$ 540
Other-financial-liabilities		
Trade and other payables (Note 20)	**79,219**	43,628
Interest-bearing borrowings (Note 24)	**7,693**	8,879
Convertible debenture – debt host (Note 25)	**115,972**	117,050
Total financial liabilities	**$ 203,286**	$ 170,097

31.2 Fair value

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

The fair values of the Company's financial instruments classified as FVTPL are determined as follows:

- The fair value of financial instruments that are traded on an active liquid market are determined with reference to the quoted market prices
- The fair value of financial instruments that are not traded in an active market are determined using generally accepted valuation models using inputs that are directly (i.e. prices) or indirectly (i.e. derived from prices) observable. The fair value of the embedded derivatives within the convertible debenture (Note 25) is determined using a Monte Carlo simulation. None of the fair value change in the embedded derivatives for the year ended December 31, 2017 is related to a change in the credit risk of the convertible debenture. All of the change in fair value is associated with changes in market conditions.
- The fair value of the notes receivables is determined based on the corporate bond yield of the bonds issued by the group companies of the notes issuing company.

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

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

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

31. Financial instruments and fair value measurements continued

31.2 Fair value continued

- 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.

Recurring measurements	As at December 31, 2017 Level 1	Level 2	Level 3	Total
Financial assets at fair value				
Notes receivables	$ 1,898	$ 10,622	–	$ 12,520
Total financial assets at fair value	**$ 1,898**	**$ 10,622**	**$ –**	**$ 12,520**
Financial liabilities at fair value				
Convertible debenture – embedded derivatives	$ –	$ 402	$ –	$ 402
Convertible debenture – debt host	–	216,154	–	216,154
Total financial liabilities at fair value	**$ –**	**$ 216,556**	**$ –**	**$ 216,556**

Recurring measurements	As at December 31, 2016 Level 1	Level 2	Level 3	Total
Financial liabilities at fair value				
Convertible debenture – embedded derivatives	$ –	$ 540	$ –	$ 540
Convertible debenture – debt host	–	217,195	–	$ 217,195
Total financial liabilities at fair value	$ –	$ 217,735	$ –	$ 217,735

There were no transfers between Level 1, 2 and 3 for the year ended December 31, 2017.

31.3 Financial risk management objectives and policies

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

Currency risk

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

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

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

31. Financial instruments and fair value measurements continued

31.3 Financial risk management objectives and policies continued

Currency risk continued

	As at December 31, 2017	2016
Increase/decrease in foreign exchange rate		
+5%	**$ (2,457)**	$ (1,684)
-5%	**$ 2,457**	$ 1,684

Interest rate risk

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

Except for the interest-bearing borrowing from the TRQ Loan (Note 24), the Company's equipment loan (Note 24), the bank loan (Note 24) and CIC Convertible Debenture (Note 25) accrue interests at fixed rates where the Company is not exposed to interest rate risk. The Company has not entered into any derivative instruments to manage interest rate fluctuations, however, management closely monitors interest rate exposure and the risk exposure is limited.

Credit risk

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

The Company's credit risk on cash arises from default of the counterparty. The Company limits its exposure to counterparty credit risk on cash by only dealing with financial institutions with high credit ratings.

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

Liquidity risk

Liquidity risk is the risk that the Company will not be able to settle or manage its obligations associated with financial liabilities. Based on the Company's forecasts for the year ended December 31, 2017, the Company is unlikely to have sufficient capital resources and does not expect to generate sufficient cash flows from mining operations in order to satisfy its ongoing obligations and future contractual commitments, including cash interest payments due on the CIC Convertible Debenture. Therefore, the Company is actively seeking additional sources of financing to continue operating and meet its objectives (Note 1).

The Company's current and expected remaining contractual maturities for its financial liabilities with agreed repayment periods are as follows. The table includes the undiscounted cash flows of financial liabilities based on the earliest date on which the Company can be required to satisfy the liabilities.

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31. Financial instruments and fair value measurements continued

31.3 Financial risk management objectives and policies continued

Liquidity risk continued

	0 to 6 months	6 to 12 months	1 to 5 years	Over 5 years	Total
As at December 31, 2017					
Trade and other payables	**$ 79,219**	**$ –**	**$ –**	**$ –**	**$ 79,219**
Interest-bearing borrowings[(i)]	**4,346**	**2,763**	**1,069**	**–**	**8,178**
Convertible debenture – cash interest[(i)]	**25,797**	**8,000**	**64,000**	**272,000**	**369,797**
	$ 109,362	**$ 10,763**	**$ 65,069**	**$ 272,000**	**$ 457,194**
As at December 31, 2016					
Trade and other payables	$ 43,628	$ –	$ –	$ –	$ 43,628
Interest-bearing borrowings	7,477	1,296	467	–	9,240
Convertible debenture – cash interest	27,696	8,000	64,000	288,000	387,696
	$ 78,801	$ 9,296	$ 64,467	$ 288,000	$ 440,564

(i) The expected undiscounted cash flows of the above noted financial liabilities include the cash interest payment on the interest-bearing borrowings and convertible debenture for the year ended December 31, 2017. Refer to Note 24 and Note 25 for the terms of the interest-bearing borrowings and convertible debenture, respectively.

Commodity price risk

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

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

32. Related party transactions

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

Name	Country of incorporation	% equity interest As at December 31, 2017	2016
SouthGobi Resources (Hong Kong) Limited	Hong Kong	**100%**	100%
SGS	Mongolia	**100%**	100%
SGQ Coal Investment Pte. Ltd.	Singapore	**100%**	100%
SouthGobi Trading (Beijing) Co., Ltd.*	China	**100%**	100%
Inner Mongolia SouthGobi Energy Co., Ltd.	China	**100%**	100%
Inner Mongolia SouthGobi Enterprise Co., Ltd.	China	**70%**	N/A

* SouthGobi Trading (Beijing) Co., Ltd. was registered as a wholly-foreign-owned enterprise under law of China.

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

32. Related party transactions continued

In additional to the transactions detailed elsewhere in profit or loss, the Company had related party transactions with the following company related by way of directors or shareholders in common during the year ended December 31, 2017:

- CIC – CIC is a major shareholder of the Company, CIC holds approximately 23.8% of the issued and outstanding common shares of the Company as at December 31, 2017. A co-operation agreement was signed on November 19, 2009 between the Company and CIC, in which an amount of service fee calculated based on 2.5% of the revenue shall be paid to CIC on a quarterly basis. During the year ended 31 December 2017, $3,103 was recorded in profit or loss (2016: $1,376).

Furthermore, the Company is in discussions with CIC for a further deferral of the November 19th Payments and the November 2017 PIK Interest; however, there can be no assurance that a favorable outcome will be reached. As part of these discussions, CIC has notified the Company that, as a condition to agreeing to any deferral, it requires that the Co-Operation Agreement between the Company and CIC be amended to revise the manner in which the amount of the service fee payable to CIC under the Co-Operation Agreement is calculated with retroactive effect; however, the Company has not entered into any formal agreement in respect of the Co-Operation Agreement as of the date hereof.

32.1 Related party expenses

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

	Year ended December 31,	
	2017	2016
Finance costs	**$ 21,315**	$ 21,279
Management fee	**3,103**	1,376
Related party expenses	**$ 24,418**	$ 22,655

32.2 Key management personnel compensation

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

	Year ended December 31,	
	2017	2016
Salaries, fees and other benefits	**$ 1,470**	$ 1,265
Share-based compensation	**58**	66
Total remuneration	**$ 1,528**	$ 1,331

33. Supplemental cash flow information

33.1 Non-cash financing and investing activities

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

	Year ended December 31,	
	2017	2016
Convertible debenture interest settlement in shares (Note 25)	**$ 4,000**	$ –
Trade receivables settled by properties for resale (Note 13)	**10,622**	–
Settlement of court case penalty via provision of mining services (Note 22)	**6,184**	2,074
Purchase of vehicles financed by loans	**222**	578
Addition to decommissioning liability (Note 26)	**765**	1,044
Depreciation and amortization capitalized in mineral properties	**7,309**	1,366
Total non-cash financing and investing activities	**$ 29,102**	$ 5,062

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

33. Supplemental cash flow information continued

33.2 Net change in non-cash working capital items

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

	Year ended December 31, 2017	2016
Decrease/(increase) in inventories	$ (15,357)	$ 608
Increase in trade and other receivables	(24,201)	(16,293)
Increase in prepaid expenses and deposits	(609)	(6,707)
Decrease in provision for court case penalty	(2,890)	(2,406)
Increase in trade and other payables	32,707	12,178
Increase in deferred revenue	8,743	17,455
Net change in non-cash working capital items	$ (1,607)	$ 4,835

34. Commitments for expenditure

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 December 31, 2017				
Capital expenditure commitments	$ 4,363	$ –	$ –	$ 4,363
Operating expenditure commitments	3,422	622	2,350	6,394
Commitments	$ 7,785	$ 622	$ 2,350	$ 10,757
As at December 31, 2016				
Capital expenditure commitments	$ 1,898	$ –	$ –	$ 1,898
Operating expenditure commitments	4,692	700	2,218	7,610
Commitments	$ 6,590	$ 700	$ 2,218	$ 9,508

Pursuant to an Investment and Collaboration Agreement dated April 2, 2016, the Company contracted with a third party to construct and operate a wash plant at the Ovoot Tolgoi mine site. Under the terms of the agreement the other party is responsible for all capital costs related to the construction of the facility and to operate the facility during the initial term of the contract, which is until 10 million tonnes of coal is washed. Upon reaching 10 million tonnes of coal washed, the ownership of the wash plant will pass to the Company. Payment for the coal washing will be Renminbi 25 per tonne covering a set amount per tonne for operating costs and a set amount per tonne as a reimbursement of the capital costs. As such, upon commencement of the operation of the wash plant, it is expected that the agreement will be accounted for as a finance lease. Management is currently in discussions with the third party contractor to renegotiate certain terms of the contract prior to the commencement of commissioning.

35. Contingencies

35.1 Mongolia's Independent Authority Against Corruption (the "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 under the section entitled "Governmental and Regulatory Investigations" above. The restrictions on the assets were reaffirmed in the Tax Verdict and formed part of the Tax Penalty payable by the Company (Note 22).

Following the termination of enforcement procedures in relation to the Tax Verdict, the orders imposed by the IAAC were removed on January 10, 2018.

35. Contingencies continued

35.2 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 directors, and its former auditors, Deloitte LLP, in the Ontario Court in relation to the Company's restatement of certain financial statements previously disclosed in the Company's public fillings (the "Restatement").

To commence and proceed with the Class Action, the plaintiff was required to bring a preliminary leave motion and to certify the Class Action as a class proceeding (the "Leave Motion"). The Ontario Court rendered its decision on the Leave Motion on November 5, 2015 and dismissed the plaintiff's Leave Motion as against each of the former senior officers and 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.

However, the Ontario Court allowed the Class Action to proceed under Part XXIII.1 of the Ontario Securities Act, permitting the plaintiff to commence and proceed with an action against the Company in respect of alleged misrepresentations affecting trades in the secondary market for the Company's securities arising from the Restatement. The Company appealed this portion of the decision of the Ontario Court (the "Corporation Appeal").

The plaintiff appealed that part of the November 5, 2015 Ontario Court decision dismissing the action against former officers and directors of the Company (the "Individual's Appeal"). The Individual's Appeal was brought as of right to the Ontario Court of Appeal.

On September 18, 2017, the Ontario Court of Appeal dismissed the Corporation Appeal of the original Ontario lower court decision to permit the plaintiff to commence and proceed with the Class Action. Concurrently, the Ontario Court of Appeal allowed the Individual's Appeal of the original Ontario lower court decision to dismiss the plaintiff's leave motion against certain of the Company's former officers and directors and made an order granting leave for the plaintiff to proceed against such former officers and directors of the Company in relation to the Restatement. As a result, the plaintiff is now permitted to proceed with the Class Action against both the Company and the former officers and directors.

The Company filed an application for leave to appeal to the Supreme Court of Canada in November 2017. Leave to appeal is expected to be decided by May, 2018. If leave to appeal is granted, the appeal would likely be scheduled to be heard in early 2019.

The Company firmly believes that it has a strong defense on the merits and will continue to vigorously defend itself against the Class Action through independent Canadian litigation counsel retained by the Company 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 potential losses, if any. However, the Company has judged a provision for this matter as at December 31, 2017 was not required.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

35. Contingencies continued

35.3 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 had a duration of five years from commencement of the contract and provided 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. Accordingly, the Company has determined a provision for this matter at December 31, 2017 is not required.

35.4 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 December 31, 2017, management has assessed that recognition of a provision for uncertain tax position is not necessary.

35.5 Mongolian royalties

During the year ended December 31, 2017, the Company has been ordered by the Mongolian tax authority to apply "reference price" determined by the Government of Mongolia as opposed to calculated sales price that derived based on the actual contract price. Although no official letter was received by the Company as of the date hereof, there can be no assurance that the Government of Mongolia will not disagree with the methodology employed by the Company in determining the calculated sales price and deem such price "non-market" under Mongolian tax law.

Management believes that its interpretation of the relevant legislation is appropriate and the Company's positions related to royalty will be sustained. As of December 31, 2017, recognition of a provision for addition Mongolian royalties is not necessary.

APPENDIX TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

ADDITIONAL STOCK EXCHANGE INFORMATION

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

A1. Director and employee emoluments

Directors' emoluments

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

	Year ended December 31, 2017	2016
Directors' fees	$ 330	$ 233
Other emoluments for executive and non-executive directors		
Salaries and other benefits	1,010	905
Share-based compensation	58	66
Directors' emoluments	**$ 1,398**	$ 1,204

Year ended December 31, 2017 Name of director	Directors' fees	Salaries and other benefits	Share-based compensation	Total
Executive directors				
Yulan Guo	$ –	$ 390	$ –	$ 390
Ningqiao Li (ii)	–	150	–	150
	$ –	$ 540	$ –	$ 540
Non-executive directors				
Zhu Liu	$ 83	$ –	$ 12	$ 95
Jin Lan Quan	70	–	12	82
Mao Sun	88	–	12	100
Aminbuhe	–	470	–	470
Yingbin Ian He (i)	49	–	22	71
Wen Yao (i)	–	–	–	–
Joseph Belan (ii)	40	–	–	40
Huiyi Wang (ii)	–	–	–	–
	$ 330	$ 470	$ 58	$ 858
Directors' emoluments	$ 330	$ 1,010	$ 58	$ 1,398

(i) Appointed to the Board of Directors during the year ended December 31, 2017.

(ii) Resigned from the Board of Directors during the year ended December 31, 2017.

APPENDIX TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

A1. Director and employee emoluments continued

Directors' emoluments continued

Year ended December 31, 2016 Name of director	Directors' fees	Salaries and other benefits	Share-based compensation	Total
Executive directors				
Ningqiao Li	$ 4	$ 285	$ –	$ 289
Aminbuhe	–	360	–	360
Yulan Guo	–	260	–	260
	$ 4	$ 905	$ –	$ 909
Non-executive directors				
Zhu Liu	$ 50	$ –	$ 14	$ 64
Jin Lan Quan	38	–	14	52
Mao Sun	72	–	19	91
Pierre Lebel (i)	36	–	–	36
Huiyi Wang (ii)	11	–	–	11
Joseph Belan (ii)	22	–	19	41
	$ 229	$ –	$ 66	$ 295
Directors' emoluments	$ 233	$ 905	$ 66	$ 1,204

(i) Resigned from the Board of Directors during the year ended December 31, 2016.

(ii) Appointed to the Board of Directors during the year ended December 31, 2016.

Five highest paid individuals

The five highest paid individuals included two directors of the Company for the years ended December 31, 2017 (2016: three director). The emoluments of the five highest paid individuals are as follows:

	Year ended December 31, 2017	2016
Salaries and other benefits	**$ 1,535**	$ 1,241
Total emoluments	**$ 1,535**	$ 1,241

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

	Year ended December 31, 2017	2016
HK$1,000,001 to HK$1,500,000	**–**	1
HK$1,500,001 to HK$2,000,000	**3**	1
HK$2,000,001 to HK$2,500,000	**–**	2
HK$2,500,001 to HK$3,000,000	**–**	1
HK$3,000,001 to HK$3,500,000	**1**	–
HK$3,500,001 to HK$4,000,000	**1**	–
	5	5

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

A2. Five year summary

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

	Year ended December 31,				
	2017	2016	2015	2014	2013
Revenue	**$ 120,973**	$ 58,450	$ 16,030	$ 24,494	$ 58,636
Gross profit/(loss)	**15,115**	(28,595)	(47,661)	(57,638)	(53,991)
Net comprehensive loss attributable to equity holders of the Company	**$ (39,600)**	$ (64,729)	$ (188,040)	$ (104,197)	$ (236,950)
Basic and diluted loss per share from continuing and discontinued operations	**$ (0.15)**	$ (0.24)	$ (0.79)	$ (0.55)	$ (1.30)

	As at December 31,				
	2017	2016	2015	2014	2013
Total assets	**$ 260,567**	$ 259,321	$ 290,474	$ 416,139	$ 506,206
Less: total liabilities	**(250,027)**	(213,308)	(179,781)	(131,858)	(131,149)
Total net assets	**$ 10,540**	$ 46,013	$ 110,693	$ 284,281	$ 375,057

A3. Cash

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

	As at December 31,	
	2017	2016
Denominated in U.S. Dollars	**$ 5,234**	$ 269
Denominated in Chinese Renminbi	**802**	296
Denominated in Mongolian Tugriks	**164**	287
Denominated in Canadian Dollars	**39**	85
Denominated in Hong Kong Dollars	**232**	29
Cash	**$ 6,471**	$ 966

CORPORATE INFORMATION

Directors

Executive Director:

Mr. Yulan Guo

Non-Executive Directors:

Mr. Wen Yao
Mr. Aminbuhe

Independent Non-Executive Directors:

Mr. Mao Sun (interim independent Lead Director)
Mr. Yingbin Ian He
Mr. Zhu Liu
Ms. Jin Lan Quan

Audit Committee

Mr. Mao Sun (Chairman)
Mr. Yingbin Ian He
Mr. Zhu Liu
Ms. Jin Lan Quan

Nominating and Corporate Governance Committee

Mr. Yingbin Ian He (Chairman)
Mr. Zhu Liu
Ms. Jin Lan Quan
Mr. Mao Sun

Compensation and Benefits Committee

Mr. Zhu Liu (Chairman)
Mr. Yingbin Ian He
Ms. Jin Lan Quan
Mr. Mao Sun

Health, Environment, Safety and Social Responsibility Committee

Mr. Aminbuhe (Chairman)
Mr. Yulan Guo
Mr. Zhu Liu

Company Secretaries

Ms. Allison Snetsinger and Mr. Siu Man Kwok

Records and Registered Office

20th floor – 250 Howe Street, Vancouver, British Columbia, Canada V6C 3R8

Principal Place of Business in Canada

1150 – 355 Burrard Street, Vancouver, British Columbia, Canada V6C 2G8

Principal Place of Business in Hong Kong

Suite 3712-15, Tower Two, Times Square, 1 Matheson Street, Causeway Bay, Hong Kong

Principal Place of Business in Mongolia

8th Floor, Monnis Building, Orgil Stadium 22, Great Mongolian State Street, 15th Khoroo,
Khan-Uul District, Ulaanbaatar, Mongolia, 17011

Principal Bankers

Canada:

BMO Bank of Montreal

Hong Kong:

Standard Chartered Bank (Hong Kong) Limited

Principal Share Registrar

AST Trust Company (Canada) (formerly CST Trust Company)
Suite 1600 – 1066 West Hastings Street, Vancouver, British Columbia, Canada V6E 3X1

Branch Share Registrar

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

Independent Auditor

PricewaterhouseCoopers LLP

Website address

SouthGobi.com