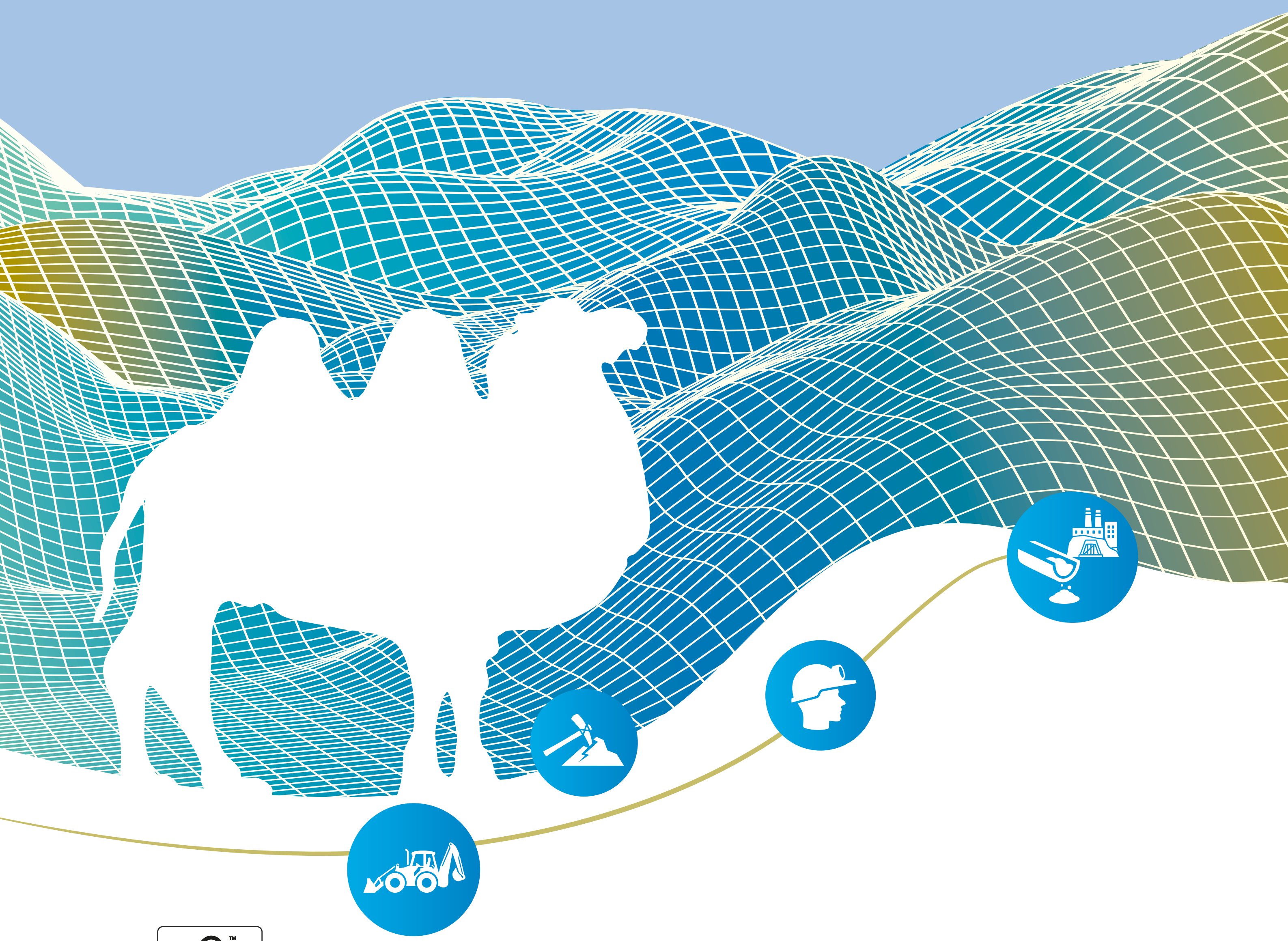
SouthGobi
RESOURCES

TSX: SGQ HKEX: 1878

SouthGobi Resources Ltd.
南戈壁资源有限公司



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SouthGobi Resources Ltd. (the "Company" or "SouthGobi") is focused on the exploration, development and production of its coking coal deposits in Mongolia's South Gobi Region. The Company has a 100% shareholding in SouthGobi Sands LLC, the Mongolian registered company that holds SouthGobi's mining 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 CEO

2018 was a year of transformation for SouthGobi. New Board members as well as a new management team were appointed during the year. The new leadership team has implemented changes to enhance SouthGobi's performance in respect of its sales strategies, operations and financial performance.

Safety continues to be our top priority, and we remain committed to operating in a safe and socially responsible manner. In 2018, the Company experienced a lost time injury frequency rate of 0.05 per 200,000 man hours (based on a rolling 12 month average as at December 31, 2018). We are proud of this accomplishment and will continue to strive to maintain such a low incident record.

Despite experiencing a decrease in revenues, SouthGobi has increased its gross profits by more than 50% as compared to the prior year, as a result of improvements in managing its cost of sales as well as the Company experiencing an increase in the average realized selling price of coal during the year. The Company also implemented changes to its sales strategies during the year and increased the portion of prepayment sales relative to credit sales, which has in turn lowered the Company's exposure to credit risk. Management also lowered production levels in 2018 to coincide with the decrease in sales during the period in order to preserve working capital.

The coal wash plant at the Ovoot Tolgoi mine site commenced commissioning in October 2018, which represents the achievement of an important milestone by the Company. So far, the Company has experienced almost a doubling of the average realized selling price of thermal coal that has been washed in the coal wash plant. The Company is in the process of improving and enhancing the operational efficiency, as well as the output throughput, of the coal wash plant. SouthGobi expects to utilize the coal wash plant to produce and sell higher volumes of higher-quality coal products at improved margins in 2019.

Since being appointed, the Company's new management team has been focused on implementing various measures to improve operational efficiency and productivity while also enhancing product quality. The Company is also monitoring and managing its liquidity and cash flows closely, and efforts were made during the year to obtain an increased number of prepayments from customers, which reduces the Company's reliance on expensive debt capital and lowers the Company's accounts receivable turnover cycle.

All of these achievements are as a result of the valued contributions from every SouthGobi employee 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.

With regards to the Special Committee's investigation into the past conduct engaged in by former senior executive officers and employees of the Company, the Special Committee has concluded its final report summarizing its key findings from the formal investigation and is in the process of assessing the potential remedial actions and preventative measures available to the Company, which will include implementing changes to the Company's existing system of internal controls and risk management policies and procedures. The management team has been fully cooperative throughout the investigation process and is committed to making every effort to prevent any similar issues from arising in the future and upholding the Company's commitment to a culture of honesty, integrity and accountability and compliance with the highest standards of professional and ethical conduct. Management is confident that the Company will be able to successfully implement the requisite remedial actions and preventative measures necessary to satisfy the requirements of the Hong Kong Stock Exchange and the Toronto Stock Exchange and allow the Company's common shares to resume trading as soon as practicable.

Looking forward to 2019, SouthGobi will continue to operate in a safe and socially responsible manner. The Company will also aim to increase coal production volume, enhance the product mix by increasing the volume of coal being washed in the coal wash plant, reduce production costs and optimize the cost structure through innovation and productivity enhancement, and continue engaging contract mining companies to improve the flexibility of production level. On the sales front, we will endeavor to increase sales volume, expand our sales network, and continue to expand the customer base to strengthen the Company's sales and logistics capabilities.

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

Shougao Wang
Chief Executive Officer and Executive Director

BRIDGE BETWEEN MONGOLIA AND CHINA

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

BOARD OF DIRECTORS AND SENIOR MANAGEMENT

Shougao Wang

Executive Director and Chief Executive Officer

Mr. Wang, 52, was appointed as Chief Executive Officer on June 1, 2018 and joined the Board as the Executive Director on July 3, 2018. Mr. Wang is also a Director of several of the Company's subsidiaries.

Mr. Wang is a seasoned mining professional, having accumulated over 30 years of international project management and operational experience, and has worked on a number of mining projects in Mongolia and across the globe.

Prior to joining the Company, Mr. Wang was Manager of Quality, Health, Safety and Environment at China Nonferrous Metal Industry's Foreign Engineering and Construction Co., Ltd. ("NFC") from March 2017 to May 2018, during which time he was responsible for project quality control, health, environmental protection, and workplace health and safety matters. From 2011 to 2017, Mr. Wang was the Chief Executive Officer of Tsairt Mineral LLC, the parent company of the Tumurtiin-Ovoo zinc mine in Mongolia. During the course of his career, Mr. Wang has held various senior project management positions at different international mining projects operated by NFC and its parent company, China Nonferrous Metal Mining (Group) Co. Ltd.

Mr. Wang is a certified engineer and obtained his Bachelor's Degree in Civil Engineering from Kunming University of Science and Technology in China in 1989 and a Master's Degree in Business Administration from Renmin University in China in 2013.

Mr. Wang is a member of the Canadian Institute of Corporate Directors.

Zhiwei Chen

Non-Executive Director

Mr. Chen, 34, joined the Board of Directors on April 13, 2018 as a Non-Executive Director.

Mr. Chen, is currently the Assistant General Manager of China Cinda (HK) Holdings Co. Limited ("Cinda HK") and the Managing Director of its investment department. Mr. Chen is responsible for managing Cinda HK's investment and financing businesses. Mr. Chen has over 10 years of investment and research experience in the financial industry. Prior to joining Cinda HK in 2010, Mr. Chen was the Executive Assistant to the Chairman of TIG Group in Singapore from 2007 to 2010 and he was responsible for TIG Group's private equity investment business in China. Prior to joining TIG Group, Mr. Chen was a research scholar at the National University of Singapore from 2005 to 2007.

Mr. Chen is a Non-Executive Director of Modern Land (China) Co., Limited, China Fortuna Financial Group, and Silver Grant International Industries Limited, each of which is listed on the Hong Kong Stock Exchange (the "SEHK").

Mr. Chen obtained his Bachelor's Degree in Economics from Tsinghua University in China in 2004 and a Master's Degree in Estate Management from National University of Singapore in 2009.

Mr. Chen is a member of the Canadian Institute of Corporate Directors.

BOARD OF DIRECTORS AND SENIOR MANAGEMENT

Lan Cheng

Non-Executive Director

Ms. Cheng, 37, joined the Board as a Non-Executive Director on June 28, 2018.

Ms. Cheng is currently a Vice President of CIC Capital Corporation ("CIC Capital"), a wholly owned subsidiary of China Investment Corporation and is responsible for evaluating investment opportunities in the metals and mining industry and post-investment management of CIC Capital's existing portfolio assets in the same sector.

Prior to joining CIC Capital in 2015, Ms. Cheng was the Senior Commercial Specialist at Chinalco Rio Tinto Exploration Company, responsible for sourcing, evaluating and negotiating investment opportunities in the mining sector. Ms. Cheng has over 10 years' experience working for various mining companies including Centerra Gold Inc., Sino Gold Mining Ltd. and Gold Fields Limited.

Ms. Cheng obtained her Bachelor's Degree in Hydrogeology in 2003 from the East China University of Technology in China. She obtained her Master's Degree in Economic Geology in 2006 from the China University of Geosciences (Beijing) in China.

Ms. Cheng is a member of the Canadian Institute of Corporate Directors.

Xiaoxiao Li

Non-Executive Director

Mr. Li, 30, joined the Board of Directors on April 13, 2018 as a Non-Executive Director.

Mr. Li, is currently the Investment Director of the Investment Department at Cinda HK and is responsible for expanding and overseeing the investment business at Cinda HK. Over the course of his career, Mr. Li has accumulated extensive experience in accounting, corporate finance, and investment management.

Prior to joining Cinda HK in 2016, Mr. Li was the Investment Manager of Dingyi Group Investment Limited, which is listed on the SEHK. Mr. Li worked in the Global Banking and Transaction Division for Intesa Sanpaolo S.p.A. from 2013 to 2015 in New York and he worked as an auditor at KPMG LLP from 2010 to 2013 in New York.

Mr. Li graduated from the University of Southern California in the United States with a Bachelor of Science in Accounting and Finance in 2010. Mr. Li is a member of the American Institute of Certified Public Accountants, Canadian Institute of Chartered Professional Accountants and Canadian Institute of Corporate Directors.

BOARD OF DIRECTORS AND SENIOR MANAGEMENT

Wen (Wayne) Yao

Non-Executive Director

Mr. Yao, 49, joined the Board of Directors on May 18, 2017 as a Non-Executive Director.

Mr. Yao is currently a Managing Director and head of the mining team at CIC Capital 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 China, 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 is a Commissioner on the Board of Commissioners of PT Bumi Resources Tbk.

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.

Yingbin Ian He

Independent Non-Executive Director

Mr. He, 57, 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 the Lead Director and 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., listed on the TSX Venture Exchange (the "TSX-V") in Canada; and a Director and non-Executive Chairman of Vatukoula Gold Mines Plc, formerly listed on the London Stock Exchange Alternative Investment Market. Mr. He has also served as a Director on the Boards of the following companies: Zhongrun Resources Investment Corporation, listed on Shenzhen Stock Exchange; Jiulian Resources Inc., listed on the TSX-V; Huaxing Machinery Corp., listed on the TSX-V; and Dolly Varden Silver Corp., listed on the TSX-V. In addition to being a former President and Director of Spur Ventures Inc., listed on the TSX-V, Mr. He was also the General Manager of its operating subsidiary Yichang Mapleleaf Chemicals Inc. In his early career, Mr. He worked as a mineral process engineer and coal preparation engineer in a Canadian mining company 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 (currently 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.

BOARD OF DIRECTORS AND SENIOR MANAGEMENT

Jin Lan Quan

Independent Non-Executive Director

Ms. Quan, 56, 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 one of the big four accounting firms 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 was previously a director of Kresta Holdings Ltd., a company listed on the Australian Stock Exchange.

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.

Mao Sun

Independent Non-Executive Director and Interim Lead Director

Mr. Sun, 43, 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, 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 Wildsky Resources Inc. (formerly China Minerals Mining Corporation), listed on the TSX-V. Mr. Sun was a Director and Chairman of the audit committee for Yalian Steel Corporation from 2012 to 2013. Prior to founding Mao & Ying 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

Weiguo Zhang

Chief Financial Officer

Mr. Zhang, 54, was appointed as Chief Financial Officer on June 1, 2018.

Mr. Zhang has over 30 years' experience in financial accounting, auditing and corporate finance. Prior to joining the Company, Mr. Zhang spent over 30 years working in a number of different senior finance roles in NFC and CNMC's various subsidiaries and global offices, including Manager of the cost control department of the first construction division of NFC from December 2017 to May 2018 and President of NFC's Kyrgyzstan office from November 2012 to December 2017.

Mr. Zhang obtained his Bachelor's Degree in Economics at Dongbei University of Finance and Economics in China. Mr. Zhang is a member of the Canadian Institute of Corporate Directors.

Aiming Guo

Chief Operating Officer

Mr. Guo, 50, was appointed as Chief Operating Officer on June 1, 2018.

Mr. Guo is a certified engineer with over 20 years' of mining project management experience. Prior to joining the Company, Mr. Guo was Deputy Chief Engineer at Shanxi Hongsha First Construction Co., Ltd. ("Shanxi Hongsha"), subsidiary of Yangquan Coal Industry Group Co., Ltd. from January 2014 until May 2018, during which time he was responsible for technical management. Mr. Guo spent over 9 years working in various management capacities in Shanxi Hongsha's Mongolia project department.

Mr. Guo holds a Bachelor's Degree in Survey Engineering from the China University of Mining and Technology.

BOARD OF DIRECTORS AND SENIOR MANAGEMENT

Tao Zhang
Vice President

Mr. Zhang, 36, was appointed as a Vice President of the Company on July 3, 2018. Mr. Zhang is also a Director of several of the Company's subsidiaries.

Prior joining the Company, Mr. Zhang was the Senior Supervisor of the Corporate Development (Investment) Department of NFC from June 2016 to May 2018. He joined NFC in March 2007 and was as a Manager in the Sales and Human Resources Departments and a Superintendent of the General Manager's office in Tsairt Mineral LLC, the parent company of the Tumurtiin-Ovoo zinc mine in Mongolia, from November 2007 to December 2012. Between December 2012 and June 2016, Mr. Zhang was a Supervisor in the Quality, Health, Safety and Environment Department of NFC.

Mr. Zhang is a certified safety engineer in China. Mr. Zhang obtained his Bachelor's Degree in Mining and Geotechnical in 2004 and a Master's Degree in Mining and Safety Engineering Management in 2006 from the Central South University in China.

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, 2018 (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 31 to the Financial Statements and the activities of all major subsidiaries of the Company as at December 31, 2018 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
SouthGobi Sands LLC	Mongolia	MNT264,369,000	Coal mining, development and exploration of properties in Mongolia
Mazaalai Resources LLC	Mongolia	MNT1,000,000	Investment holding
SouthGobi Resources (Hong Kong) Limited	Hong Kong	HK$1	Business services and 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 operating segment 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 50 to 119 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 Statements of Comprehensive Income on page 134 of this Annual Report.

Dividends

The Board does not recommend the payment of any final dividend for the Financial Year (2017: Nil). No interim dividend was declared or paid during the Financial Year (2017: 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 26 to the Financial Statements and in the Consolidated Statements of Changes in Equity on page 136 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, 2018 are set out in the Consolidated Statements of Changes in Equity on page 136 of this Annual Report.

Directors

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

Current Directors

Executive Director

Mr. Shougao Wang [(1)(2)]

Non-Executive Directors

Mr. Zhiwei Chen [(3)]
Ms. Lan Cheng [(4)]
Mr. Xiaoxiao Li [(3)]
Mr. Wen (Wayne) Yao

Independent Non-Executive Directors (the "INEDs")

Mr. Yingbin Ian He
Ms. Jin Lan Quan
Mr. Mao Sun *(Interim Independent Lead Director)*

Prior Directors

Independent Non-Executive Director

Mr. Zhu Liu [(5)]

Non-Executive Directors

Mr. Aminbuhe [(6)(7)]
Mr. Yulan Guo [(6)(7)(8)]

Notes:

1) Mr. Wang is an Executive Director and the CEO of the Company;

2) Mr. Wang joined the Board and was appointed as an Executive Director on July 3, 2018;

3) Messrs. Chen and Li joined the Board as non-executive Directors on April 13, 2018;

4) Ms. Cheng joined the Board as a non-executive Director on June 28, 2018;

5) Mr. Liu did not stand for re-election at the 2018 Annual General Meeting (the "2018 AGM") and ceased to be an INED on June 28, 2018;

6) Messrs. Aminbuhe and Guo did not stand for re-election at the 2018 AGM and ceased to be non-executive Directors. Mr. Guo 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) To the knowledge of the Company's directors and senior management, Messrs. Aminbuhe and Guo 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, 2018; and

8) Mr. Guo was re-designated from an Executive Director to a non-executive Director on June 1, 2018.

Except where such Director has already resigned from the Board, the term of office for each of the Directors will end at the conclusion of the forthcoming annual general meeting (the "2019 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 2019 AGM.

The Company has received written annual confirmations of independence from Messrs. He, 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 2019 AGM have 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, 2018, 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:

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

	Number of Shares and underlying Shares held, capacity and nature of interest						
		Number of Shares interested			Number of underlying Shares interested		
Name of Directors	Directly beneficially owned	Through spouse or minor children	Through controlled company	Beneficiary of a trust	Directly beneficially owned	Total [4]	Approximate percentage of SGQ's issued Shares [5]
Current Directors							
Shougao Wang	–	–	–	–	400,000 [2]	400,000	0.15%
Yingbin Ian He	–	–	–	–	400,000 [2]	400,000	0.15%
Jin Lan Quan	–	–	–	–	550,000 [2]	550,000	0.20%
Mao Sun	–	–	–	–	700,000 [2]	700,000	0.26%
Former Directors							
Aminbuhe	–	–	25,768,162 [1][3]	–	100,000 [2]	25,868,162	9.49%
Yulan Guo	–	–	25,768,162 [1][3]	–	100,000 [2]	25,868,162	9.49%
Zhu Liu	–	–	–	–	400,000 [2]	400,000	0.15%

Notes:

(1) 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.

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

(3) Messrs. Aminbuhe and Yulan Guo are directors and shareholders of Voyage Wisdom Limited, a private company which owned a 9.45% interest in the Company as at December 31, 2018.

(4) All interests stated above are long positions.

(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, 2018 (i.e. 272,702,835 Shares).

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, 2018.

Share option plan

The particulars of the Company's share option plan (the "Share Option Plan") are set out in Note 27 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, 2018	Granted during the year	Exercised during the year	Forfeited during the year	Expired during the year	At December 31, 2018	Date of grant [1]	Exercise period of share options	Exercise price of share options [2][3] Cdn$ per share
Current Directors									
Shougao Wang	n/a	400,000	–	–	–	400,000	16-Aug-18	Aug. 16 2019 – Aug. 16 2023	0.13
	–	**400,000**	**–**	**–**	**–**	**400,000**			
Zhiwei Chen	n/a	n/a	n/a	n/a	n/a	n/a			
	–	–	–	–	–	–			
Lan Cheng	n/a	n/a	n/a	n/a	n/a	n/a			
	–	–	–	–	–	–			
Xiaoxiao Li	n/a	n/a	n/a	n/a	n/a	n/a			
	–	–	–	–	–	–			
Wen (Wayne) Yao	n/a	n/a	n/a	n/a	n/a	n/a			
	–	–	–	–	–	–			
Yingbin Ian He	100,000	–	–	–	–	100,000	5-Jun-17	Jun. 5, 2018 – Jun. 5, 2022	0.39
	150,000	–	–	–	–	150,000	30-Jun-17	Jun. 30, 2018 – Jun. 30, 2022	0.33
	–	150,000	–	–	–	150,000	3-Jul-18	Jul. 3, 2019 – Jul. 3, 2023	0.13
	250,000	**150,000**	**–**	**–**	**–**	**400,000**			
Jin Lan Quan	100,000	–	–	–	–	100,000	14-Dec-15	Dec. 14, 2016 – Dec. 14, 2020	0.29
	150,000	–	–	–	–	150,000	16-Nov-16	Nov. 16, 2017 – Nov. 16, 2021	0.33
	150,000	–	–	–	–	150,000	30-Jun-17	Jun. 30, 2018 – Jun. 30, 2022	0.33
	–	150,000	–	–	–	150,000	3-Jul-18	Jul. 3, 2019 – Jul. 3, 2023	0.13
	400,000	**150,000**	**–**	**–**	**–**	**550,000**			
Mao Sun	100,000	–	–	–	–	100,000	14-Dec-15	Dec. 14, 2016 – Dec. 14, 2020	0.29
	200,000	–	–	–	–	200,000	16-Nov-16	Nov. 16, 2017 – Nov. 16, 2021	0.33
	200,000	–	–	–	–	200,000	30-Jun-17	Jun. 30, 2018 – Jun. 30, 2022	0.33
	–	200,000	–	–	–	200,000	3-Jul-18	Jul. 3, 2019 – Jul. 3, 2023	0.13
	500,000	**200,000**	**–**	**–**	**–**	**700,000**			
Former Directors									
Aminbuhe	100,000	–	–	–	–	100,000	14-Dec-15	Dec. 14, 2016 – Jun. 28, 2019	0.29
	100,000	**–**	**–**	**–**	**–**	**100,000**			
Yulan Guo	100,000	–	–	–	–	100,000	14-Dec-15	Dec. 14, 2016 – Jun. 28, 2019	0.29
	100,000	**–**	**–**	**–**	**–**	**100,000**			
Zhu Liu	100,000	–	–	–	–	100,000	14-Dec-15	Dec. 14, 2016 – Jun. 28, 2019	0.29
	150,000	–	–	–	–	150,000	16-Nov-16	Nov. 16, 2017 – Jun. 28, 2019	0.33
	150,000	–	–	–	–	150,000	30-Jun-17	Jun. 30, 2018 – Jun. 28, 2019	0.33
	400,000	**–**	**–**	**–**	**–**	**400,000**			
Total for Directors	**1,750,000**	**900,000**	**–**	**–**	**–**	**2,650,000**			
Other share option holders	8,885	–	–	–	–	8,885	26-Mar-14	Mar. 26, 2015 – Mar. 26, 2019	0.65
	24,134	–	–	–	–	24,134	13-Aug-14	Aug. 13, 2015 – Aug. 13, 2019	0.58
	157,443	–	–	–	–	157,443	1-Apr-15	Apr. 1, 2016 – Apr. 1, 2020	0.92
	–	1,930,000	–	(75,000)	–	1,855,000	16-Aug-18	Aug. 16 2019 – Aug. 16 2023	0.13
Total for other share option holders:	**190,462**	**1,930,000**	**–**	**(75,000)**	**–**	**2,045,462**			
TOTAL:	**1,940,462**	**2,830,000**	**–**	**(75,000)**	**–**	**4,695,462**			

DIRECTORS' REPORT

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

(1) The vesting period of the share options is from the date of grant until the commencement of the exercise period.

(2) 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.

(3) The closing prices of the Company's shares immediately before the date on which the options were granted on July 3, 2018 and August 16, 2018 were CAD$0.16 and CAD$0.13, respectively.

The directors have estimated the values of the share options granted to Messrs. Yingbin Ian He, Mao Sun and Ms. Jin Lan Quan were US$7,192, US$9,590 and US$7,192, respectively, during the year, calculated using Black-Scholes option pricing model as at the date of grant of the share options.

The directors have estimated the values of the share options granted to Messrs. Shougao Wang, Weiguo Zhang, Aiming Guo and Tao Zhang were US$14,670, US$7,335, US$7,335 and US$7,335, 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. In January 2019, the Board of Directors approved the suspension of the Company's Share Purchase Plan.

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, 2018, 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.à-r.l. (b)	Beneficial	64,766,591	23.75%
Fullbloom Investment Corporation (b)	Interest of a controlled corporation	64,766,591	23.75%
China Investment Corporation ("CIC") (b)	Interest of controlled corporations	64,766,591	23.75%
Novel Sunrise Investments Limited ("Novel Sunrise") (c)	Beneficial	46,358,978	17.00%
Hope Rosy Limited (c)	Interest of a controlled corporation	46,358,978	17.00%
China Cinda (HK) Investments Management Company Limited (c)	Interest of controlled corporations	46,358,978	17.00%
China Cinda (HK) Holdings Company Limited (c)	Interest of controlled corporations	46,358,978	17.00%
China Cinda Asset Management Co., Limited (c)	Interest of controlled corporations	46,358,978	17.00%
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.à-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.à-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 listed on the Hong Kong Stock Exchange under the ticker symbol HK1359. Accordingly, each of Hope Rosy Limited, China Cinda (HK) Investments Management Company Limited, China Cinda (HK) Holdings Company Limited, and China Cinda Asset Management Co., Limited was deemed to be interested in Shares held by Novel Sunrise.

(d) To the knowledge of the Company's directors and senior management, messrs. Aminbuhe and Guo are directors and shareholders of Voyage Wisdom Limited, a private company which owned 9.45% interest in the Company as at December 31, 2018.

(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, 2018 (i.e. 272,702,835 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, 2018.

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 27 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.à-r.l. (the "CIC Convertible Debenture"), and, subject to certain exceptions, while the CIC Convertible Debenture is outstanding or while Land Breeze II S.à-r.l. beneficially owns directly or indirectly 15% of the outstanding Shares, Land Breeze II S.à-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 28% of the Company's purchases.

The five largest suppliers accounted for 70% of the Company's purchases in aggregate.

Sales

The largest customer accounted for 39% of the Company's sales.

The five largest customers accounted for 78% 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$76,445 (2017: US$65,085).

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 31 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 2019 AGM to re-appoint PricewaterhouseCoopers LLP as independent auditor of the Company.

On behalf of the Board

Mao Sun
Interim Independent Lead Director
March 31, 2019

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.

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 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, a Nominating and Corporate Governance Committee, a Compensation and Benefits Committee and a Health, Environment, Safety and Social Responsibility ("HESS") Committee;
- reviewed, and approved amendments as required 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 as required to, the Company's Disclosure Controls and Procedures, and the Corporate Disclosure and Securities Trading Policy;
- reviewed, and approved amendments as required 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");
- reviewed, and approved amendments as required to, the Shareholder Communication Policy;
- reviewed, and approved amendments as required to, the Board Diversity Policy;
- approved and adopted a policy setting out the factors that the Board shall consider in determining if and when dividends should be declared;
- approved and adopted a policy setting out the duties of the Significant Contract Committee and related procurement guidelines for the approval of significant contracts;
- reviewed, and approved amendments as required 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;
- participated in a 'Introduction to Coal Mining and Beneficiation' seminar;

- commissioned reports from independent third parties on remuneration for the Company's executive management and INEDs; and
- established an independent special committee of the Company ("Special Committee"), comprised entirely of INEDS, to initiate and oversee a formal internal investigation into the charges against the Company's former Chairman and CEO and the suspicions of serious fraud, misappropriation of Company assets and other criminal acts ("Suspicious Transactions") arising from the past conduct engaged in by former senior executive officers and employees of the Company (the "Former Management and Employees"). The Company filed a report with local police authorities in the People's Republic of China ("China") in respect of certain of the Suspicious Transactions.

In connection with its internal investigation into the Suspicious Transactions (the "Formal Investigation"), the Special Committee has completed the following actions:

- engaged Blake, Cassels & Graydon LLP ("Blakes"), as independent Canadian legal counsel, and Zhong Lun Law Firm ("Zhong Lun"), as independent Chinese legal counsel, to assist in the Formal Investigation. The Special Committee and Zhong Lun engaged Ernst & Young (China) Advisory Limited (the "Forensic Accountant"), as forensic investigator, to oversee the forensic investigation;
- instructed Blakes and Zhong Lun to conduct a review of the Company's applicable policies and procedures from the perspectives of both Canadian and PRC law, respectively;
- instructed the Forensic Accountant to complete a forensic investigation report, which was completed on March 27, 2019; and
- concluded the Formal Investigation and delivered a final report summarizing its key findings to the Board, which was adopted and approved at a Board meeting held on March 30, 2019.

As of the date of this report, the Special Committee, with the assistance of its professional advisors, is in the process of assessing the potential remedial actions and preventative measures available to the Company to address the issues examined during the Formal Investigation, which will include amendments to the Company's existing system of internal controls and risk management policies and procedures to improve and strengthen the Company's commitment to a culture of honesty, integrity and accountability and compliance with the highest standards of professional and ethical conduct, and such other actions as the Special Committee may consider necessary or appropriate to protect the Company's interests. For more information regarding the Formal Investigation and the material findings of the Special Committee in respect of the Suspicious Transactions that were investigated pursuant to the Formal Investigation, please see the section entitled "*Ad Hoc/ Special Committees – Formal Investigation*" of this report.

Implementation of Corporate Governance Policies

The Board has considered carefully the requirements of the Corporate Governance Code ("Corporate Governance Code") set out in Appendix 14 of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (the "Listing Rules") and, save as disclosed below, in the opinion of the Directors, the Company had complied with the code provisions set out in the Corporate Governance Code throughout the year ended December 31, 2018:

- pursuant to code provision A.2 of the Corporate Governance Code, the chairman of the Board should be responsible for the overall management of the Board. The Company has not had a Chairman since November 2017. However, the Board has appointed an Interim Independent Lead Director, who is fulfilling the duties of the Chairman;
- pursuant to code provision C.2.5, the Company should have an internal audit function. 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. As noted above, the Special Committee, with the assistance of its professional advisors, is in the process of assessing the potential remedial actions and preventative measures available to the Company to address the issues examined during the Formal Investigation, which will include amendments to the Company's existing

CORPORATE GOVERNANCE REPORT

system of internal controls and risk management policies and procedures as well as re-evaluate the need to set up an internal audit function;

- 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 (an "AGM"). Mr. Sun, an INED and the Interim Independent Lead Director, attended and acted as chairman of the Company's annual general meeting held on June 28, 2018 (the "2018 AGM") to ensure effective communication with shareholders of the Company ("Shareholders").

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 the Company's governance documents and policies included in the Code of Conduct Standards. The Code of Conduct Standards were originally adopted and implemented in 2012. In connection with the Formal Investigation, the Special Committee also instructed its professional advisors to conduct a review of the Company's applicable governance policies and procedures from the perspectives of both Canadian and PRC law. Even though the review confirmed that the content of the Company's governance policies and procedures complies with applicable Canadian and PRC law, the Special Committee concluded that there was a clear lack of adherence to the existing policies and a flouting of internal controls on the part of the Former Management and Employees.

The Code of Conduct Standards provides that the Company's Directors, officers, employees and consultants 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, including the Shareholder Communication Policy, Majority Voting 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 the Company's personnel to raise concerns confidentially and anonymously.

The Nominating and Corporate Governance Committee monitors compliance with the Code of Conduct Standards and is responsible for establishing systems to verify compliance with legal, regulatory, corporate governance and disclosure requirements.

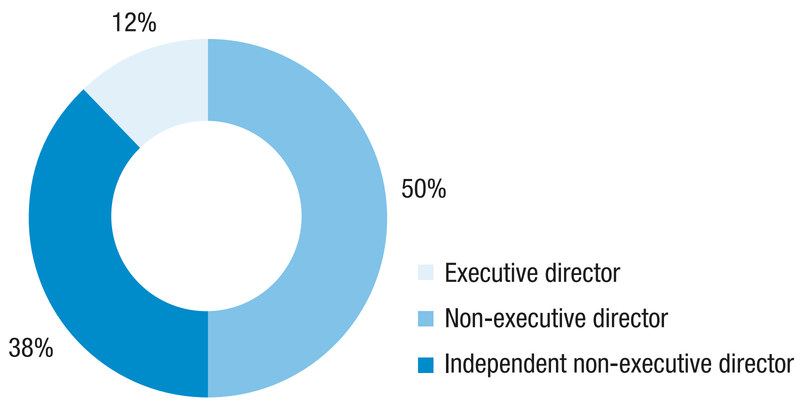
As of the date of this report, the Special Committee, with the assistance of its professional advisors, is in the process of assessing the potential remedial actions and preventative measures available to the Company to address the issues examined during the Formal Investigation, which will include amendments to the Company's existing system of internal controls and risk management policies and procedures to improve and strengthen the Company's commitment to a culture of honesty, integrity and accountability and compliance with the highest standards of professional and ethical conduct, and such other actions as the Special Committee may consider necessary or appropriate to protect the Company's interests. For more information regarding the Formal Investigation and the material findings of the Special Committee in respect of the Suspicious Transactions that were investigated pursuant to the Formal Investigation, please see the section entitled "*Ad Hoc/ Special Committees – Formal Investigation Report*" of this report.

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.

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 has determined that three (3) of its eight (8) current members (Messrs. He, Sun and Ms. Quan) are independent, representing 38% of all Board members. Moreover, seven (7) of the eight (8) Directors are non-executive Directors.

Board composition



Although a majority of the Board are not independent Directors, the Board is of the view that appropriate structures and procedures are in place to allow the Board to function independently of management. The Board has appointed an INED as Interim Independent Lead Director who is responsible for providing overall leadership of the Board and maintaining the independence of the Board. In the event that the Board must consider a potential or actual conflict, such matter is referred to the INEDs and is subject to independent scrutiny. To facilitate the exercise of independent judgment, the INEDs and non-executive directors of the Board hold meetings as required. In 2018, the INEDs met one (1) time. During the Financial Year, the Directors were/are as follow:

CORPORATE GOVERNANCE REPORT

2018 BOARD COMPOSITION

Current Directors

Executive Director:

Mr. Shougao Wang (1)(2)

Non-Executive Directors:

Mr. Zhiwei Chen (3)
Ms. Lan Cheng (4)
Mr. Xiaoxiao Li (3)
Mr. Wen (Wayne) Yao

Independent Non-Executive Directors:

Mr. Yingbin Ian He
Ms. Jin Lan Quan
Mr. Mao Sun *(Interim Independent Lead Director)*

Prior Directors

Non-Executive Directors:

Mr. Aminbuhe (5)(6)
Mr. Yulan Guo (5)(6)(7)

Independent Non-Executive Director:

Mr. Zhu Liu (8)

Notes:

1) Mr. Wang is an Executive Director and the CEO of the Company;

2) Mr. Wang joined the Board and was appointed as an Executive Director on July 3, 2018;

3) Messrs. Chen and Li joined the Board as non-executive Directors on April 13, 2018;

4) Ms. Cheng joined the Board as a non-executive Director on June 28, 2018;

5) Messrs. Aminbuhe and Guo did not stand for re-election at the 2018 AGM and ceased to be non-executive Directors. Mr. Guo 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;

6) To the knowledge of the Company's directors and senior management, Messrs. Guo and Aminbuhe 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, 2018;

7) Mr. Guo was re-designated from an Executive Director to a non-executive Director on June 1, 2018; and

8) Mr. Liu did not stand for re-election at the 2018 AGM and ceased to be an INED on June 28, 2018.

As at March 31, 2019, each of China Investment Corporation ("CIC") (through its wholly-owned subsidiary Land Breeze II S.a.r.l.), China Cinda Asset Management Company Limited (through its wholly-owned subsidiary Novel Sunrise Investments Limited), and Voyage Wisdom Limited held approximately 23.8%, 17.0% and 9.5% 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. Shougao Wang, the Company's Executive Director, has been the Company's CEO since June 1, 2018, 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 three (3) of the seven (7) 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: (i) Mr. Yao and Ms. Cheng were nominated by CIC, a substantial shareholder, for election to the Board pursuant to CIC's nomination rights under a security holders' agreement executed by and among the Company, CIC, and Turquoise Hill Resources Ltd. and (ii) Messrs. Chen and Li were nominated by Novel Sunrise Investments Limited ("Novel Sunrise"), a substantial shareholder, for election to the Board pursuant to Novel Sunrise's nomination rights under a subscription agreement executed between the Company and Novel Sunrise.

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. Please see the section entitled "*Ad Hoc/Special Committees*" of this report.

In discharging this responsibility, the Board Mandate provides that the Board will oversee and monitor 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.

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.

CORPORATE GOVERNANCE REPORT

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. In 2018, the mandate of the Special Committee was expanded to include oversight of the investigation into the suspicions of serious fraud, misappropriation of Company assets and other criminal acts arising from the past conduct engaged in by former senior executive officers and employees of the Company. For more information, please see the section entitled "*Ad Hoc/Special Committees – Formal Investigation*" of this report.

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.

Below please find the composition of the Company's Board Committees:

Audit [1][2]	Nominating and Corporate Governance [1][2]	Compensation and Benefits [1][2]	HESS [2][3][5]	Special[1]
Yingbin Ian He	Yingbin Ian He (Chair)	Yingbin Ian He	Lan Cheng	Yingbin Ian He
Jin Lan Quan	Jin Lan Quan	Jin Lan Quan (Chair)	Aiming Guo [4]	Jin Lan Quan
Mao Sun (Chair)	Mao Sun	Mao Sun	Yingbin Ian He	Mao Sun (Chair)
			Shougao Wang (Chair)	

Notes:

1) The Audit, Nominating and Corporate Governance, Compensation and Benefits and Special Committees are comprised of solely INEDs.

2) Mr. Zhu Liu ceased to be a member of the Audit, Nominating and Corporate Governance, Compensation and Benefits and HESS Committees on June 28, 2018.

3) Mr. Yulan Guo ceased to be a member of the HESS Committee on June 28, 2018.

4) Mr. Aiming Guo is the Company's Chief Operating Officer and a member of the HESS Committee.

5) Mr. Aminbuhe ceased to be a member of the HESS Committee on April 1, 2018.

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 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. During the Financial Year, the Board reviewed the Audit Committee charter and no changes were recommended for the charter; however, in March 2019 the Audit Committee charter was updated to incorporate mandatory requirement established by the Hong Kong Stock Exchange with respect to audit committee membership eligibility.

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.

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.

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. Please see the section entitled *"Risk Management and Internal Controls*" of this report; 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. During the Financial Year, the Board reviewed the Nominating and Corporate Governance Committee charter and the Board Mandate in light of current best practices. The Company has adopted guidelines and procedures in its Nominating and Corporate Governance Committee charter that are no less exacting than those set out in the Corporate Governance Code and Corporate Governance Report, Mandatory Disclosure Requirement L. (d)(ii) in Appendix 14 to the Hong Kong Listing Rules relating to the creation of a Nomination Policy.

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 with a view to ensure 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.

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 the Company's Disclosure Controls and Procedures and the Corporate Disclosure and Securities Trading Policy;
- reviewed the Board Diversity Policy;
- reviewed the Shareholder Communication Policy;
- reviewed 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 approved amendments to the written position descriptions for the Chairman, Lead Director, CEO and CFO, as well as the Chairmen of the Audit, Nominating and Corporate Governance, Compensation and Benefits Committees clearly defining their respective roles and responsibilities.

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. During the Financial Year, the Board reviewed the Compensation and Benefits Committee charter and no changes were recommended for the charter.

The primary objective of the Compensation and Benefits Committee is to discharge the Board's responsibilities relating to the determination of remuneration and benefits for the Directors and executive officers of the Company. This role includes reviewing and approving executives' remuneration 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.

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

- reviewed and made recommendations to the Board with respect to the adequacy and forms of the Company's remuneration policy relating to the remuneration 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 remuneration of the CEO, CFO, COO and the Vice President evaluating their performance and setting their remuneration levels;
- recommended to the Board the performance evaluation of the CEO, CFO, COO and the Vice President, 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.

CORPORATE GOVERNANCE REPORT

In 2016 and 2017 the Compensation and Benefits Committee engaged Roger Gurr & Associates, a Canadian professional compensation and benefits consultancy firm, to conduct a review of the remuneration program for the Company's independent non-executive Directors and executive management, and Spencer Ogden Energy, a Hong Kong based energy recruitment firm, to conduct a review of the remuneration program for the Company's executive management. The reports provided by both Roger Gurr & Associates and Spencer Ogden Energy continue to be utilized by the Compensation and Benefits Committee in determining the remuneration for the Company's independent non-executive Directors and executive management.

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. The primary objective of the HESS Committee is to assist the Board of Directors in fulfilling its oversight responsibilities by monitoring and reviewing performance, and recommending for approval policies and management systems, with respect to health, environmental, safety and social responsibility related matters affecting the Company.

Annually, the HESS Committee reviews the Company's environmental, social and governance report (the "ESG Report") and provides guidelines and recommendations to the Company's management relating to the findings in the ESG Report. During the Financial Year, the HESS Committee reviewed its charter in light of current best practices.

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.

Formal Investigation

In November 2017, the Special Committee, comprised of Messrs. He and Sun 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. In December 2018, the mandate of the Special Committee was expanded to include oversight of the Formal Investigation into the Suspicious Transactions arising from the past conduct engaged in by Former Management and Employees, and their impact, if any, on the business and affairs of the Company. The Special Committee engaged Blakes, as an independent Canadian legal counsel, Zhong Lun, as an independent Chinese legal counsel, and the Special Committee and Zhong Lun engaged the Forensic Accountant to assist in the Formal Investigation. Mr. Sun is the chairman of the Special Committee.

The Formal Investigation concentrated on the following areas of focus (the "Areas of Focus"): (i) the arrangements of the Suspicious Transactions; (ii) the relationships between the Former Management and Employees and certain coal trading and transportation companies; (iii) any unidentified questionable transactions relating to the Former Management and Employees; and (iv) the potential impact of (i), (ii) and (iii) on the financial statements of the Company and its subsidiaries. During the course of the Formal Investigation, certain incomplete accounting/operational records of one of the Companies Under Investigation (as defined below) ("Company A") were identified in Company's employee computers. As a result, the Special Committee expanded the scope of the Area of Focus of the Formal Investigation to include: (i) a fund flow analysis of Company A; and (ii) a price analysis of the difference between Company A's purchase prices from the Company and selling prices to downstream customers.

Based on the Areas of Focus, the Special Committee examined and made findings in respect of a number of matters in connection with the Formal Investigation, including the following: (i) allegations that Mr. Aminbuhe, the Company's former Chairman and Chief Executive Officer, controlled certain companies the Company had business dealings (the "Companies Under Investigation"); (ii) uncollectable receivables from certain former customers and suppliers of the Company; (iii) the impact of the lawsuit filed by Jiayuguan Xiyuan Trading Co., Ltd.; and (iv) allegations of misconduct by the Former Management and Employees, including: (I) the grant of a RMB5 million loan; (II) embezzlement of bank acceptance bills of RMB12 million; (III) endorsement of commercial acceptance bills of RMB71 million which were not supported by genuine commercial transactions; (IV) prepayments of RMB8.5 million for coal transportation services which were never received by the Company; and (V) prepayment of RMB16.4 million for coal transportation services which were never received by the Company. Details of the material findings of the Special Committee in respect of the Suspicious Transactions that were investigated pursuant to the Formal Investigation are set out in the Company's press release dated March 31, 2019, a copy of which is available under the Company's profile on SEDAR at www.sedar.com.

Based on the information obtained from the Formal Investigation, the Special Committee has concluded that the four matters examined in connection with the Formal Investigation, having an aggregate value of approximately RMB41 million, involved improper conduct, fraud or misappropriation of assets (the "Fraudulent Transactions") and that one matter examined in connection with the Formal Investigation, having an aggregate value of approximately RMB71 million, involved an accounting reclassification error. From an accounting perspective, the Company does not anticipate that the Fraudulent Transactions will have any impact on its financial statements in the future, as the Company has already recorded the appropriate provisions in the financial statements as at December 31, 2018, 2017 and 2016 and for the years then ended.

Restatement of Prior Year Financial Information

Based on the key findings of and information obtained from the Formal Investigation, the Company has considered the resulting financial impact on the financial statements and determined that a restatement of prior period financial information is required. A summary of the requisite adjustments on the financial statements for the fiscal years ended 2016 and 2017 is set forth in the table below.

Summary of Adjustments (in millions of US$)	Year ended December 31, 2016	2017
Statement of Comprehensive Income		
Increase/(Decrease) of Net Comprehensive Loss	4.8	(2.1)
Statement of Financial Position		
(Decrease) of Total Assets	(4.8)	(7.1)
(Decrease) of Total Liabilities	–	(4.4)
Increase of Deficiency in Assets	4.8	2.7

As of the date of this report, the Special Committee, with the assistance of its professional advisors, is in the process of assessing the potential remedial actions and preventative measures available to the Company to address the issues which caused the Trading Suspension, which will include amendments to the Company's existing system of internal controls and risk management policies and procedures to improve and strengthen the Company's commitment to a culture of honesty, integrity and accountability and compliance with the highest standards of professional and ethical conduct, and such other actions as the Special Committee may consider necessary or appropriate to protect the Company's interests. The Special Committee expects to deliver its recommendations with respect to these matters to the Board on or before April 30, 2019.

CORPORATE GOVERNANCE REPORT

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 separately from management. If required, between regularly scheduled Board meetings, a meeting of INEDs, chaired by the Interim Independent 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.

2018 Board and Committee Meetings		
Total Number of Board Meetings:		**21**
	In-Person:	3
	Via Conference Call:	18
Total Number of Audit Committee Meetings:		**6**
	In-Person:	2
	Via Conference Call:	4
Total Number of Nominating and Corporate Governance Committee Meetings:		**9**
	In-Person:	2
	Via Conference Call:	7
Total Number of Compensation and Benefits Committee Meetings:		**6**
	In-Person:	2
	Via Conference Call:	4
Total Number of HESS Committee Meetings:		**3**
	Ovoot Tolgoi Mine Site:	1
	In-Person:	1
	Via Conference Call:	1
Total Number of Special Committee Meetings:		**3**
	In-Person:	2
	Via Conference Call:	1

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

CORPORATE GOVERNANCE REPORT

Attendance by the Directors at the 2018 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	2018 AGM	Board meetings	Audit Committee meetings	Nominating and Corporate Governance Committee meetings	Compensation and Benefits Committee meetings	HESS Committee meetings	Independent Special Committee meetings
	(Number of Attendances/Number of Meetings)						
Executive Director							
Mr. Shougao Wang [1]	0/1	11/11	N/A	N/A	N/A	2/2 [2]	N/A
Non-Executive Directors							
Mr. Zhiwei Chen [3]	0/1	14/15	N/A	N/A	N/A	N/A	N/A
Ms. Lan Cheng [4]	0/1	11/12	N/A	N/A	N/A	2/2 [5]	N/A
Mr. Xiaoxiao Li [3]	0/1	15/15	N/A	N/A	N/A	N/A	N/A
Mr. Wen (Wayne) Yao	1/1	19/21	N/A	N/A	N/A	N/A	N/A
Independent Non-Executive Directors							
Mr. Yingbin Ian He	0/1	20/21	6/6	9/9	6/7	2/2 [5]	3/3
Ms. Jin Lan Quan	1/1	21/21	6/6	9/9	7/7	N/A	3/3
Mr. Mao Sun *(Interim Independent Lead Director)*	1/1	21/21	6/6	9/9	7/7	1/1 [6]	3/3
Prior Directors							
Independent Non-Executive Director							
Mr. Zhu Liu [7]	0/1	9/9 [7]	2/2 [7]	5/7 [7]	4/4 [7]	1/1 [7]	N/A
Non-Executive Directors							
Mr. Aminbuhe [8]	0/1	0/9 [8]	N/A	N/A	N/A	N/A [9]	N/A
Mr. Yulan Guo [8]	0/1	8/9 [8]	N/A	N/A	N/A	1/1 [8]	N/A

Notes:

1) Mr. Wang joined the Board and was appointed as Executive Director of the Company on July 3, 2018 and there were eleven (11) meetings of the Board following that date.

2) Mr. Wang joined the HESS Committee on July 3, 2018 and there were two (2) meetings of the HESS Committee following that date.

3) Messrs. Chen and Li joined the Board as non-executive Directors on April 13, 2018 and there were fifteen (15) meetings of the Board following that date.

4) Ms. Cheng joined the Board on June 28, 2018 and there were twelve (12) meetings of the Board following that date.

5) Mr. He and Ms. Cheng joined the HESS Committee on July 3, 2018 and there were two (2) meetings of the HESS Committee following that date.

6) Mr. Sun was a member of the HESS Committee from April 1, 2018 to July 3, 2018 and there was one (1) meeting of the HESS Committee during that time period.

7) Mr. Liu did not stand for re-election at the 2018 AGM and ceased to be a member of any Board committees following the conclusion of the 2018 AGM.

8) Messrs. Aminbuhe and Guo did not stand for re-election at the 2018 AGM and Mr. Guo ceased to be a member of the HESS Committee following the conclusion of the 2018 AGM.

9) Mr. Aminbuhe ceased to be a member of the HESS Committee on April 1, 2018.

The 2018 AGM was held in Vancouver, Canada on June 28, 2018 and was attended by Mr. Sun in-person. Ms. Quan and Mr. Yao attended the 2018 AGM 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.

2018 Professional Development	
All Directors:	**Canadian Institute of Corporate Directors (the "ICD") membership:** As a means of facilitating continuing education opportunities for the Directors, all Directors are members of the ICD and have the opportunity to attend on-line courses, conducted by the ICD, 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. **Corporate Governance seminar**: Conducted by the Company's external legal counsel, the seminar detailed the Company's multi-jurisdictional obligations including: • Canadian rules and regulations under Corporate and Securities laws; • Corporate Governance Code obligations; • Toronto Stock Exchange and Hong Kong Stock Exchange obligations; • Canadian regulatory oversight of emerging market issuers; and • current issues in Canadian public company regulation. Additional segments of the Corporate Governance seminar will be held in 2019. **Introduction to Coal Mining and Beneficiation:** Conducted by Mr. Yingbin Ian He (a member of the Board), the seminar provided the Directors with information relating to the origin of coal and beneficiation technology. **Independent Director's Role in Corporate Governance:** This e-seminar hosted by the Hong Kong Stock Exchange provided the Directors with additional information relating to the Hong Kong Stock Exchange's new corporate governance requirements. The topics covered in the e-seminar included: • Corporate governance update 2018; • Appointment of INEDs; • INEDs' Role; • Directors' attendance at meetings and dividend policy; • Weighted voting rights issuers' corporate governance requirements; and • Key messages and conclusions.

2018 Professional Development	
Mao Sun:	**ICD:** • Executive Compensation Trends: Key Learnings from the 2018 Proxy Season; • Top Priorities for Audit Committees in 2018; • Successful Dynamics on International Boards; and • Executive Pay at Private Enterprises **Chartered Professional Accountants of British Columbia:** • Employment Standards Overview; • Safe Income: A Comprehensive Review, Basic Tax Compliance in Self- Employment; and • The Societies Act – Transition and Other Changes. **British Columbia Tax Conference**
Jin Lan Quan:	**ICD:** • Top Priorities for Audit Committees in 2018 **United Kingdom Association of Chartered Certified Accountant:** • Currency and Accounting **Accounting Professionals:** • Bribery and Corruption **Chartered Accountants Australia:** • The Role of Chartered Accountants in Driving Positive Culture and Integrity in Organizational Conduct • Hong Kong Stock Exchange regulatory e-training seminar.
Yingbin Ian He	**Recent Trends in Corporate Governance** **Inbound M&A: What Directors Need to Know**

Throughout the Financial Year, all of the Directors were provided with written materials to support their professional development. In addition to the above mentioned professional development programs, during the Financial Year, Ms. Cheng and Messrs. Chen, Li and Yao continued their professional development by reviewing materials on directors' roles and functions and corporate governance practices.

Ethical Business Conduct

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 is responsible for establishing systems to verify compliance with legal, regulatory, corporate governance and disclosure requirements.

As of the date of this report, the Special Committee, with the assistance of its professional advisors, is in the process of assessing the potential remedial actions and preventative measures available to the Company to address the issues examined during the Formal Investigation, which will include amendments to the Company's existing system of internal controls and risk management policies and procedures to improve and strengthen the Company's commitment to a culture of honesty, integrity and accountability and compliance with the highest standards of professional and ethical conduct, and such other actions as the Special Committee may consider necessary or appropriate to protect the Company's interests. For more information regarding the Formal Investigation and the material findings of the Special Committee in respect of the Suspicious Transactions that were investigated pursuant to the Formal Investigation, please see the section entitled "*Ad Hoc/ Special Committees – Formal Investigation*" of this report.

Shareholder Communication Policy

The Company has a Shareholder Communication Policy which 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.

In accordance with the Board Diversity Policy, Ms. Jin Lan Quan joined the Board as of August 6, 2015 and Ms. Lan Cheng joined the Board on June 28, 2018.

Ms. Quan joined the Audit Committee on September 1, 2015, the Nominating and Corporate Governance Committee on December 14, 2015, the Compensation and Benefits Committee on June 30, 2016 and the Special Committee on November 16, 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.

Ms. Cheng joined the HESS Committee on July 3, 2018. Ms. Cheng has over ten years' experience working for various mining companies including Centerra Gold Inc., Sino Gold Mining Ltd. and Gold

Fields Limited. Ms. Cheng is currently a Vice President of CIC Capital Corporation (“CIC Capital”), a wholly owned subsidiary of CIC and is responsible for evaluating investment opportunities in the metals and mining industry and management of CIC Capital’s existing portfolio assets in the same sector. Prior to joining CIC Capital in 2015, Ms. Cheng was a Senior Commercial Specialist at Chinalco Rio Tinto Exploration Company and responsible for sourcing, evaluating and negotiating investment opportunities in the mining sector.

The Board currently consists of two (2) women and (6) men, with females representing 25% 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, 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. The Nominating and Governance Committee believes that the Board should be comprised of directors with a broad range of experience and expertise and utilizes a skills matrix to identify those areas which are necessary for the Board to carry out its mandate effectively. The following table reflects the diverse skill set requirements of the Board and identifies the specific experience and expertise brought by each individual Director nominee.

Director	Corporate Governance	Mining Industry	General Business Management	Compensation/ Human Resources	Finance	Audit	Mongolia Specific	Public Company	China Specific	Mining Expertise
Shougao Wang	✓	✓	✓	✓	✓		✓		✓	✓
Zhiwei Chen	✓	✓	✓		✓				✓	
Lan Cheng		✓		✓	✓				✓	
Xiaoxiao Li		✓			✓	✓			✓	
Wen Yao	✓	✓	✓		✓		✓	✓	✓	
Yingbin Ian He	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Jin Lan Quan	✓		✓	✓	✓	✓		✓	✓	
Mao Sun	✓		✓	✓	✓	✓		✓	✓	

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 AGM following his or her most recent election or appointment.

At every AGM, the Shareholders entitled to attend and vote at the AGM 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 AGM, 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 "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 remuneration for non-management Directors to ensure that such remuneration 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 remuneration report commissioned from Roger Gurr & Associates (the "Roger Gurr Report"), 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 Chair:	20,000
Nominating and Corporate Governance Committee Chair:	20,000
Compensation and Benefits Committee Chair:	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.

As recommended in the Roger Gurr Report, Mr. He and Ms. Quan each received 150,000 incentive stock options on July 3, 2018, which will expire after five (5) years with a strike price of CAD$0.13 per share. In the capacity of the Interim Independent Lead Director, Mr. Sun received 200,000 incentive stock options on July 3, 2018, which expire after five (5) years with a strike price of CAD$0.13 per share.

Mr. Shougao Wang, the Company's CEO, received 400,000 incentive stock options on August 16, 2018, which expire after five (5) years with a strike price of CAD$0.13 per share. Messrs. Weiguo Zhang, the Company's CFO, Aiming Guo, the Company's COO and Tao Zhang, the Company's Vice President, each received 200,000 incentive stock options on August 16, 2018, which will expire after five (5) years with a strike price of CAD$0.13 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.

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.

On March 27, 2019, the Special Committee concluded the Formal Investigation into the Suspicious Transactions engaged in by the Former Management and Employees and delivered a final report summarizing its key findings to the Board, which was adopted and approved at a meeting held on March 30, 2019. A summary of the material findings of the Special Committee in respect of the Suspicious Transactions that were investigated pursuant to the Formal Investigation is set out in the section entitled "*Ad Hoc/Special Committees – Formal Investigation*" of this report.

Based on the information obtained from the Formal Investigation, the Special Committee has concluded that the four matters examined in connection with the Formal Investigation, having an aggregate value of approximately RMB41 million, involved the Fraudulent Transactions and that one matter examined in connection with the Formal Investigation, having an aggregate value of approximately RMB71 million, involved an accounting reclassification error. From an accounting perspective, the Company does not anticipate that the Fraudulent Transactions will have any impact on its financial statements in the future, as the Company has already recorded the appropriate provisions in its financial statements as at December 31, 2018, 2017 and 2016 and for the year then ended.

Based on the key findings of and information obtained from the Formal Investigation, the Company has considered the resulting financial impact on the financial statements and determined that a restatement of prior period's financial information is required. A summary of the requisite adjustments on the financial statements for the fiscal years ended 2016 and 2017 is set out in the section entitled "*Ad Hoc/Special Committees – Formal Investigation*" of this report.

During the reporting period, the Board worked with the Audit Committee to review all material internal controls, including financial, operational and compliance controls and risk management functions in respect of the effectiveness of the Company's internal control system, adequacy of resources and qualifications and experience of staff of the Company's accounting and financial reporting function, and the Board is satisfied that, save for the issues identified by management of the Company (details of which are disclosed in the section entitled "Risk Management and Internal Controls – Disclosure Controls and Procedures and Internal Controls Over Financial Reporting" below), the internal control procedures were effective and in compliance with the Company's policies.

CORPORATE GOVERNANCE REPORT

The Board is committed to remediating in a timely manner the deficiencies in internal controls and risk management systems identified in the section entitled "Risk Management and Internal Controls – Disclosure Controls and Procedures and Internal Controls Over Financial Reporting" below. As of the date of this report, the Special Committee, with the assistance of its professional advisors, is in the process of assessing the potential remedial actions and preventative measures available to the Company to address the issues examined during the Formal Investigation, which will include amendments to the Company's existing system of internal controls and risk management policies and procedures to improve and strengthen the Company's commitment to a culture of honesty, integrity and accountability and compliance with the highest standards of professional and ethical conduct, and such other actions as the Special Committee may consider necessary or appropriate to protect the Company's interests. The Special Committee expects to deliver its recommendations with respect to these matters to the Board on or before April 30, 2019.

Because of their inherent limitations, internal controls and risk management systems can provide only reasonable assurance and may not prevent or detect misstatements due to error or fraud. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by individual acts, by collusion of two or more individuals or by unauthorized override of controls. 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.

Disclosure Controls and Procedures and Internal Controls Over Financial Reporting

Disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by the Company in its annual filings, interim filings or other reports filed or submitted by it under applicable 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 applicable 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 is 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 Internal Financial Reporting Standards ("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, and which are designed with the objective of providing reasonable assurance that: (i) 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 (ii) unauthorized acquisition, use or disposition of assets that could have a material effect on the financial statements is prevented or detected in a timely manner.

As discussed in the section entitled "*Ad Hoc/Special Committee – Restatement of Prior Year Financial Information*" of this report, the Company has restated certain items in its statement of financial position as at December 31, 2017 and January 1, 2017 and statement of comprehensive income for the year ended December 31, 2017. The amounts of each adjustment and a reconciliation between the previously published statements of financial position and statement of comprehensive income have been presented in the section entitled "*Ad Hoc/Special Committee– Restatement of Prior Year Financial Information*" of this report.

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.

CORPORATE GOVERNANCE REPORT

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. As of December 31, 2018, the Chief Executive Officer and Chief Financial Officer of the Company have each concluded that the Company's disclosure controls and procedures were not effective due to the identification of certain material weaknesses as outlined below. Pursuant to applicable Canadian securities laws, a "material weakness" is defined as a deficiency, or combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial report will not be prevented or detected on a timely manner.

Management identified the following material weaknesses relating to the design and effectiveness of the internal controls over financial reporting as of December 31, 2018:

- inadequate "know your customer" procedures in relation to the intake of new customers and insufficient due diligence undertaken prior to granting credit to customers, which increased the Company's exposure to credit risk;
- inadequate controls relating to the payment authorization and contract approval processes, which increased the risk of the Company entering into unauthorized or improper transactions;
- insufficient segregation of duties which increased the risk of bad actors colluding to act in ways which are detrimental to the Company;
- insufficient control of performing reconciliations of balances with customers or suppliers on a regular basis with documentation retained; and
- lack of a centralized information technology function which increased the risk of non-compliance with Company established documentation retention requirements.

Management is committed to remediating the material weaknesses in a timely manner, with appropriate oversight from the Audit Committee. Since the appointment of the new senior management team in June 2018, the Company has taken proactive steps to address the issues which gave rise to the Suspicious Transactions, including enhancing the Company's contractual approval matrix and strengthening the controls relating to the payment authorization and contract approval process.

The Special Committee, with the assistance of its professional advisors, is in the process of assessing the potential remedial actions and preventative measures available to the Company to address the issues which caused the Trading Suspension, which will include amendments to the Company's existing system of internal controls and risk management policies and procedures to improve and strengthen the Company's commitment to a culture of honesty, integrity and accountability and compliance with the highest standards of professional and ethical conduct, and such other actions as the Special Committee may consider necessary or appropriate to protect the Company's interests.

Because of their inherent limitations, internal controls over financial reporting can provide only reasonable assurance and may not prevent or detect misstatements due to error or fraud. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by individual acts, by collusion of two or more individuals or by unauthorized override of controls. 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.

CORPORATE GOVERNANCE REPORT

Auditors

PricewaterhouseCoopers LLP, Chartered Professional Accountants, are the Company's Auditors and they report that they are independent of the Company in accordance with Chartered Professional Accountants of British Columbia, Code of Professional Conduct.

PricewaterhouseCoopers LLP will be nominated at the upcoming 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$959,000.

These fees are detailed below:

Nature of services rendered		Fees paid/payable (CAD$000's)
Audit fees [1]		848
Audit related fees		111
Total	$	959

Note:

1) Fees for audit services 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) 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

Since 2016, the Company has been developing plans to change its 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 at the Ovoot Tolgoi mine was completed, and operations at the wash plant commenced, in October 2018. The Company sold 0.2 million tonnes of washed coal in the fourth quarter of 2018. The Company is in the process making improvements to the wash plant in order to enhance the operational efficiency, as well as the output throughput. The Company is currently in discussions with the wash plant operator concerning an agreement regarding the operation of the wash plant; however, there can be no assurance that a favorable outcome will be reached.

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 to be undertaken in 2019 and 2020 and the Company to make 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, 2019, 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 80 to page 83 of this annual report.

Company Secretary

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, Ms. Snetsinger was the Company's Assistant Corporate Secretary from the time of its 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 Listing Rules.

The Company has also appointed Mr. Siu Man Kwok as Hong Kong Company Secretary of the Company. He is a Chartered Governance Professional of the Institute of Chartered Secretaries and Administrators in England ("ICSA") and The Hong Kong Institute of Chartered Secretaries ("HKICS") as well as a fellow member of each of ICSA, HKICS, the Institute of Financial Accountants in England, the Institute of Public Accountants in Australia, 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 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 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.

On behalf of the Board

Allison Snetsinger
Corporate Secretary
March 31, 2019

A LARGE RESOURCES AND RESERVES BASE

The Ovoot Tolgoi Deposit has mineral reserves of 114.1 million tonnes, while the aggregate coal resources include measured and indicated mineral resources of 194.6 million tonnes and inferred resources of 32.1 million tonnes.

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 time 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 June 2017 Deferral Agreement (as such term is defined below), the Turquoise Hill Resources Ltd. ("Turquoise Hill") loan (the "TRQ Loan"), the Bank Loan and 2018 Bank Loan (as defined below), and the Settlement Deed (as defined below) with First Concept Industrial Group Limited ("First Concept"), 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 Outstanding Cash Interest Payable and the PIK Interest Shares, (as such terms are defined below) under the June 2017 Deferral Agreement and CIC Convertible Debenture;
- the ability of the Company to successfully respond to any enforcement proceeding brought by First Concept in respect of the Arbitration Award and Settlement Deed;
- 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 impact of the Suspicious Transactions (as defined below) engaged in by Former Management and Employees (as defined below) and the results of the investigation conducted by the Special Committee (as defined below);
- the remedial actions and preventative measures the Company will implement to address the issues which caused the Trading Suspension (as defined below);
- the ability of the Company to successfully satisfy the conditions necessary to resume trading of the Common Shares on the Toronto Stock Exchange ("TSX") and the Hong Kong Stock Exchange ("HKEX");
- the expected timing to complete the actions set out in the Trading Resumption Plan (as defined below) and to resume trading of the Common Shares on the HKEX and TSX;
- 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 (as described under Section 7 of this MD&A under the heading entitled "*Regulatory Issues and Contingencies – Toll Wash Plant Agreement with Ejin Jinda*");

Forward-Looking Statements continued

- the ability of the Company to successfully negotiate a new agreement with the third party contractor relating to the operation of the wash plant at the Ovoot Tolgoi mine site;
- the ability of the Company to successfully recover the balance of its doubtful trade and notes receivables;
- the ability to enhance the operational efficiency and the output throughput of the of the washing facilities at Ovoot Tolgoi;
- the estimated annual wet washing capacity of the washing facilities at Ovoot Tolgoi;
- the ability to enhance the product value by conducting coal processing and coal washing;
- 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 impact of the delays in the customs clearance process at the Ceke border on the Company's operations and the restrictions established by Chinese authorities on the import of F-grade coal into China;
- the future demand for coal in China;
- future trends in the Chinese coal industry;
- the Company's outlook and objectives for 2019 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; the Company's anticipated business activities, planned expenditures and corporate strategies; management's business outlook, including the outlook for 2019 and beyond; the Special Committee completing its assessment of the potential remedial actions and preventative measures available to the Company, and the Board approving a set of specific actions and measures, in a timely manner; currency exchange rates; operating, labour and fuel costs; the ability of the Company to raise additional financing; 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 customs clearance process at the Ceke border; the restrictions established by Chinese authorities on the import of F-grade coal into China; the Company being in default under the CIC Convertible Debenture, the June 2017 Deferral Agreement and the TRQ Loan, including the risk of CIC accelerating all amounts outstanding

Forward-Looking Statements continued

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, respectively; the risk of the Company failing to successfully negotiate a deferral of the Outstanding Cash Interest Payable, and the PIK Interest Shares, (as such terms are defined below) 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 or its subsidiaries defaulting under its existing debt obligations, including the Bank Loan and 2018 Bank Loan, and the Settlement Deed; 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 that First Concept initiates legal proceedings against SouthGobi Sands LLC ("SGS"), a subsidiary of the Company, pursuant to the Settlement Deed (as described under Section 6 of this MD&A under the heading entitled "*Liquidity and Capital Resources – Commercial Arbitration in Hong Kong*"); the outcome of the Class Action (as described under Section 7 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 and the impact thereon on the Company; the risk that the Company fails to properly implement the remedial actions and preventative measures to address the issues which caused the Trading Suspension; the risk that the remedial actions and preventative measures fail to successfully address the issues which caused the Trading Suspension; the risk that the Company is unable to satisfy the conditions required to resume trading of the Common Shares on the TSX and the HKEX, including the risk that the Company fails to properly complete its Trading Resumption Plan; the risk that the Common Shares are delisted from trading on the TSX and the HKEX; 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; the risk of continued delays in the customs clearance process at the Ceke border; risks relating to the Company's decision to suspend activities relating to the development of the Ceke Logistics Park project, including the risk that its investment partner may initiate legal action against the Company for failing to comply with the underlying agreements governing project development; risks relating to the ability of the Company to enhance the operational efficiency and the output throughput of the washing facilities at Ovoot Tolgoi; the risk that the Company is unable to successfully negotiate a new agreement with the third party contractor relating to the operation of the wash plant; 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.

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 speak only as of the date of this MD&A; they should not rely upon this information as of any other date.

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

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Introduction

This MD&A is dated as of March 31, 2019 should be read in conjunction with the consolidated financial statements of the Company and the notes thereto for the year ended December 31, 2018. 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.

Prior to January 1, 2018, the functional currency of the Company's Mongolian operations (SGS, Mazaalai Resources LLC, Mazaatt Holdings LLC and Dayarbulag LLC), was the United States Dollar. The functional currency of the Company's Chinese subsidiaries (SouthGobi Trading (Beijing) Co., Ltd., Inner Mongolia SouthGobi Energy Co., Ltd., and Inner Mongolia SouthGobi Enterprise Co., Ltd.) was Renminbi ("RMB") and the functional currency for the Company's joint venture (RDCC LLC) was the Mongolian Tugrik ("MNT"). Per International Accounting Standard ("IAS") 21 – The Effects of Changes in Foreign Exchange Rates, an entity's functional currency should be determined based on the underlying transactions, events and conditions relevant to the entity.

Determination of functional currency involves certain judgments to determine the primary economic environment and this is re-evaluated if events or conditions change. Based on management's re-evaluation, taking into consideration the primary economic environment in which the Mongolian operations carries on its business, management determined that the functional currency of the Mongolian operations changed from US dollars to MNT as at January 1, 2018 given increased mining and administrative costs that are denominated in MNT.

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

Introduction continued

The change in functional currency of the Mongolian operations was applied prospectively from January 1, 2018 onwards in accordance with IAS 21. On January 1, 2018 (being the date on which the change in functional currency took effect), all items on the statement of financial position of the Mongolian operations were translated into MNT at the exchange rate on that date.

All figures in this MD&A are presented in U.S. dollars unless otherwise stated.

Disclosure of a scientific or technical nature in this MD&A in respect of the Company's material mineral projects was prepared by or under the supervision of the 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 506 employees as at December 31, 2018. The Company's common shares ("Common Shares") are listed for trading on the TSX under the symbol SGQ and on the 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.

1. Overview continued

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 its Chinese subsidiaries at the stockyards in Ceke (Ceke, on the Chinese side of the Shivee Khuren Border Crossing, which 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 customers.

Saleable products from the Ovoot Tolgoi Mine primarily consist of SouthGobi standard ("Standard") and SouthGobi premium ("Premium") semi-soft coking coal products. Some higher ash content product is washed and sold as semi-soft coking coal product while some of the unwashed product is sold as a thermal coal product, as and when the market allows.

Significant Events and Highlights

The Company's significant events and highlights for the year ended December 31, 2018 and the subsequent period to March 31, 2019 are as follows:

- ***Operating Results*** – With a higher proportion of sales made through Inner Mongolia SouthGobi Energy Co., Ltd. ("IMSGE"), a subsidiary of the Company, in 2018, the Company experienced an increase in the average selling price of coal from $28.3 per tonne in 2017 to $37.1 per tonne in 2018. The Company sold 2.8 million tonnes in 2018 as compared to 4.7 million tonnes in 2017, which was mainly as a result of the delays in the customs clearance process at the Ceke border which the Company has been experiencing since July 2017, as well as the decreased production level for 2018.

- ***Financial Results*** – The Company recorded a gross profit of $24.0 million in 2018 compared to $15.1 million in 2017, while a $10.5 million loss from operations was recorded in 2018 compared to a $14.6 million loss from operations in 2017 (Restated). The improvement of overall financial results when compared to 2017 is as a result of the Company experiencing a higher average selling price for coal in China during the year.

- ***Wash plant*** – The construction of the wash plant at the Ovoot Tolgoi mine was completed, and commissioning at the wash plant commenced, in October 2018. The Company sold 0.2 million tonnes of washed coal in the fourth quarter of 2018. The Company is in the process of making improvements to the wash plant in order to enhance the operational efficiency, as well as the output throughput. The Company is currently in discussions with the wash plant operator concerning an agreement regarding the operation of the wash plant; however, there can be no assurance that a favorable outcome will be reached.

1. Overview continued

Significant Events and Highlights continued

- ***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"). Pursuant to the terms of the CIC Convertible Debenture, the Company was required to pay $8.1 million, $7.9 million and $8.1 million of anniversary cash interest to CIC on November 19, 2017, May 19, 2018 and November 19, 2018, respectively (the "Anniversary Interest Payments" and together with the June 2017 Deferral Agreement Payment, the "Outstanding Cash Interest Payable"). Pursuant to the CIC Convertible Debenture, the Company was also obligated to issue to CIC $4.0 million worth of payment in kind ("PIK") interest shares on November 19, 2017 and $4.0 million worth of PIK interest shares on November 19, 2018 (collectively, the "PIK Interest Shares").

  As of the date of this MD&A, the Company: (i) has neither paid the Outstanding Cash Interest Payable nor issued the 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. Furthermore, the Common Shares have now been suspended from trading on the HKEX and TSX for a period of more than 5 trading days since December 17, 2018 (the "Trading Suspension"), which represents another event of default under the CIC Convertible Debenture. 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 payment of amounts outstanding under the CIC Convertible Debenture and the June 2017 Deferral Agreement.

  The Company has been in discussions with CIC for a deferral of the Outstanding Cash Interest Payable and the PIK Interest Shares; however, there can be no assurance that a favorable outcome will be reached.

  As a consequence of the Company not entering into a deferral agreement with CIC as at December 31, 2018, International Accounting Standard ("IAS") 1 requires the Company to classify the entire balance of the CIC Convertible Debenture as a current liability as at December 31, 2018, 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.

1. Overview continued

Significant Events and Highlights continued

- ***Notice of Legal Proceedings from a Former Customer*** – On September 20, 2018, the Company announced that IMSGE had received a court summons (the "Summons") from the Ejinaqi People's Court of Inner Mongolia Autonomous Region of China (the "Ejinaqi Court") in relation to a dispute over certain coal sales contracts with Jiayuguan Xiyuan Trading Co., Ltd ("Xiyuan"), a former customer of IMSGE.

  According to the Summons, Xiyuan applied to the Ejinaqi Court claiming that IMSGE should repay a sum of RMB19.4 million (approximately $2.8 million) to Xiyuan, comprised of RMB19.1 million of coal prepayments and RMB0.3 million of interest. Xiyuan also claimed against Ejinaqi Fulemeng Energy Industry Co., Ltd. ("FLM") for joint liability of the above sums, as it alleged that FLM acted as an agent for IMSGE to receive coal prepayment and deliver coal on behalf of IMSGE.

  On January 24, 2019, the Company received noticed that the Ejinaqi Court rendered a judgement allowing an application by Xiyuan to voluntarily withdraw its lawsuit against IMSGE and FLM. Xiyuan's application cited a lack of evidence.

- ***Notice of Arbitration*** – On January 10, 2018, the Company received a confidential partial ruling (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 (as amended) between SGS and First Concept (together the "Coal Supply Agreement") (the "Arbitration").

  Pursuant to the Arbitration Award, SGS was 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 was final, except as to costs which were reserved for a future award.

  On November 14, 2018, the Company executed a deed of settlement ("Settlement Deed") with First Concept in respect of the Arbitration Award. Pursuant to the Settlement Deed, which provides for the full and final satisfaction of the Arbitration Award as well as the settlement of the issue of costs relating to the Arbitration and any other disputes arising out of the Coal Supply Agreement, SGS agreed to pay to First Concept the sum of $13.9 million ("Settlement Sum"), together with simple interest thereon at the rate of 6% per annum from November 1, 2018 until full payment, in 12 monthly installments commencing in November 2018. Provided that SGS complies with the terms of the Settlement Deed, First Concept agreed to waive its costs in connection with the Arbitration and interest for the period from January 4, 2018 to October 31, 2018.

  As of the date hereof, the Company has not paid the November 2018 and January 2019 monthly payments due under the Settlement Deed. On March 5, 2019, SGS received a notice from First Concept claiming that the Company is in default under the Settlement Deed and demanding payment of the full amount of the outstanding monthly payments due under the Settlement Deed, otherwise First Concept intends to commence legal action against SGS pursuant to the Settlement Deed. The Company is consulting with its independent litigation counsel regarding this matter; however, as a default is only triggered under the Settlement Deed where there has been a failure to pay two or more consecutive monthly instalment payments, the Company is of the view that SGS is not in default under the Settlement Deed. In the event that First Concept commences legal action against SGS regarding this matter, the Company intends to take appropriate steps to respond to such legal proceedings in the best interests of the Company through independent litigation counsel which has been retained by the Company for this purpose.

  As at December 31, 2018, the outstanding amount payable to First Concept amounted to $12.5 million (December 31, 2017: $13.9 million).

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

1. Overview continued

Significant Events and Highlights continued

- ***Special Committee*** – On November 17, 2017, the Board formed a special committee of independent non-executive directors (the "Special Committee") to initiate a formal internal investigation into certain legal charges against Mr. Aminbuhe (the Company's former Chairman and Chief Executive Officer) and the connection, if any, between those charges and the Company and his conduct as Chairman and Chief Executive Officer of the Company.

  On May 7, 2018, the Company provided an update on the status of its ongoing internal investigation into the charges against Mr. Aminbuhe, and reported that, to the best of its knowledge, the PRC authorities had not laid charges against Mr. Aminbuhe, made any public statement of the basis for Mr. Aminbuhe's arrest or sought information from the Company in respect of this matter. The Company further reported that it was not aware of any definitive information which would suggest that Mr. Aminbuhe's arrest is related to any misconduct directly related to his position as Chairman and Chief Executive Officer of the Company.

  With the assistance of its external legal counsel, the Special Committee has conducted an extensive review of the records involving or relating to Mr. Aminbuhe which are in the Company's possession (including communications to and from Mr. Aminbuhe's email account with the Company, relevant public disclosure and other internal documents), and interviewed several directors and senior officers of the Company who had direct contact with Mr. Aminbuhe during his tenure as Chairman and Chief Executive Officer of the Company.

  On December 17, 2018, the Company announced that it had learned of certain information relating to past conduct engaged in by former senior executive officers and employees of the Company ("Former Management and Employees") which raised suspicions of serious fraud, misappropriation of Company assets and other criminal acts by the Former Management and Employees relating to prior transactions ("Suspicious Transactions") between 2016 and the first half of 2018 involving the Company, IMSGE and certain coal trading and transportation companies, some of which are allegedly related to or controlled by the Former Management and Employees or their related persons. The Company filed a report with local police authorities in China in respect of certain of the Suspicious Transactions and, on December 17, 2018, the Board expanded the mandate of the Special Committee to include a formal investigation (the "Formal Investigation") of the Suspicious Transactions, the implicated Former Management and Employees, and their impact, if any, on the business and affairs of the Company. The Special Committee engaged Blake, Cassels & Graydon LLP as independent Canadian legal counsel, Zhong Lun Law Firm, as independent Chinese legal counsel, and Ernst & Young (China) Advisory Limited (the "Forensic Accountant"), as forensic accountants, to assist in the formal investigation.

  On March 15, 2019, the Company provided a quarterly update on the status of the Formal Investigation pursuant to Rules 13.09 (2)(a) and 13.24A of the Rules Governing the Listing of Securities on the HKEX ("HKEX's Listing Rules"), and reported that: (i) the Forensic Accountant had submitted a draft investigation report to the Special Committee; and (ii) the Special Committee would review the findings of the investigation report and work with the Company's independent auditors and legal counsel to assess the financial and legal implications and to plan for any further actions.

1. Overview continued

Significant Events and Highlights continued

- ***Key Findings of Formal Investigation*** – On March 30, 2019, the Company announced that the Special Committee concluded the Formal Investigation and delivered a final report summarizing its key findings to the Board, which was adopted and approved at a meeting held on March 30, 2019.

  The Formal Investigation concentrated on the following areas of focus (the "Areas of Focus"): (i) the arrangements of the Suspicious Transactions; (ii) the relationships between the Former Management and Employees and certain coal trading and transportation companies; (iii) any unidentified questionable transactions relating to the Former Management and Employees; and (iv) the potential impact of (i), (ii) and (iii) on the financial statements of the Company and its subsidiaries. During the course of the Formal Investigation, certain incomplete accounting/operational records of one of the Companies Under Investigation (as defined below) ("Company A") were identified in Company's employee computers. As a result, the Special Committee expanded the scope of the Area of Focus of the Formal Investigation to include: (i) a fund flow analysis of Company A; and (ii) a price analysis of the difference between Company A's purchase prices from the Company and selling prices to downstream customers.

  Based on the Areas of Focus, the Special Committee examined and made findings in respect of a number of matters in connection with the Formal Investigation, including the following: (i) allegations that Mr. Aminbuhe, the Company's former Chairman and Chief Executive Officer, controlled certain companies the Company had business dealings (the "Companies Under Investigation"); (ii) uncollectable receivables from certain former customers and suppliers of the Company; (iii) the impact of the lawsuit filed by Xiyuan; and (iv) allegations of misconduct by the Former Management and Employees, including: (I) the grant of a RMB5 million loan; (II) embezzlement of bank acceptance bills of RMB12 million; (III) endorsement of commercial acceptance bills of RMB71 million which were not supported by genuine commercial transactions; (IV) prepayments of RMB8.5 million for coal transportation services which were never received by the Company; and (V) prepayment of RMB16.4 million for coal transportation services which were never received by the Company.

  Based on the information obtained from the Formal Investigation, the Special Committee has concluded that four matters examined in connection with the Formal Investigation, having an aggregate value of approximately RMB41 million, involved improper conduct, fraud or misappropriation of assets (the "Fraudulent Transactions") and that one matter examined in connection with the Formal Investigation, having an aggregate value of approximately RMB71 million, involved an accounting reclassification error. From an accounting perspective, the Company does not anticipate that the Fraudulent Transactions will have any impact on its financial statements in the future as the Company has already recorded the appropriate provisions in the financial statements as at December 31, 2018, 2017 and 2016 and for the years then ended.

  Based on the key findings of and information obtained from the Formal Investigation, the Company has considered the resulting financial impact on the financial statements and determined that a restatement of prior period financial information is required. For more information, please see Section 1 of this MD&A entitled "Overview – Significant Events and Highlights – Restatement of Prior Year Financial Information" below.

  As of the date of this MD&A, the Special Committee, with the assistance of its professional advisors, is in the process of assessing the potential remedial actions and preventative measures available to the Company to address the issues which caused the Trading Suspension, which will include amendments to the Company's existing system of internal controls and risk management policies and procedures to improve and strengthen the Company's commitment to a culture of honesty, integrity and accountability and compliance with the highest standards of professional and ethical conduct, and such other actions as the Special Committee may consider necessary or appropriate to protect the Company's interests.

1. Overview continued

Significant Events and Highlights continued

- ***Trading Suspension on HKEX and TSX*** – Subsequent to the announcement made by the Company on December 17, 2018 in relation to the Suspicious Transactions, the Common Shares have been suspended from trading on the HKEX and TSX since December 17, 2018.

  On January 3, 2019, the HKEX provided the Company with certain resumption guidance, setting out the conditions which the Company must satisfy in order for trading of the Common Shares to resume on the HKEX. Pursuant to the resumption guidance, the Company is required to: (i) conduct a forensic investigation (the "Forensic Investigation") of the Suspicious Transactions involving the Former Management and Employees; (ii) disclose the findings of the Forensic Investigation and take appropriate remedial actions; and (iii) inform the market of all material information in order for the Company's shareholders and investors to appraise the Company's position. The HKEX has advised that it may modify or supplement the trading resumption guidance if the Company's situation changes. Pursuant to Rule 6.01A(1) of the HKEX's Listing Rules, the HKEX may cancel the listing of any securities that have been suspended from trading for a continuous period of 18 months. In the case of the Company, this 18-month period expires on June 16, 2020. The HKEX has also advised that if the Company fails to remedy the issues causing the Trading Suspension, fully comply with the HKEX's Listing Rules to the HKEX's satisfaction and resume trading of the Common Shares on the HKEX by June 16, 2020, the Listing Department of the HKEX will recommend that the HKEX's Listing Committee proceed with cancelling the Company's listing on the HKEX. Pursuant to Rules 6.01 and 6.10 of the HKEX's Listing Rules, the HKEX also has the right to impose a shorter specific remedial period, where appropriate. Pursuant to Rule 13.24A of the HKEX's Listing Rules, the Company is required to announce quarterly updates on developments relating to its Trading Resumption Plan (as defined below), including details of the actions taken, or to be taken, in order to remedy the issues causing the Trading Suspension and fully comply with the HKEX's Listing Rules, the progress of implementing the Trading Resumption Plan, details of any material change to the Trading Resumption Plan (including any delays thereof) and impact on the Company's business operations. The Company was required to make its first quarterly update on or before March 16, 2019 and is required to announce additional updates every three months thereafter until resumption of trading on the HKEX or cancellation of the Company's listing on the HKEX (whichever is earlier).

  On March 30, 2019, the Company announced that, based on the key findings of, and information obtained from, the Formal Investigation, and with the advice of its professional advisors, the Board approved the principal actions, together with the related dates of completion or anticipated completion, set forth in the table below (collectively, the "Trading Resumption Plan") in order to address the issues which caused the Trading Suspension, re-comply with the HKEX's Listing Rules and allow trading of the Common Shares to resume trading on the HKEX:

1. Overview continued

Significant Events and Highlights continued

- ***Trading Suspension on HKEX and TSX*** continued

Action Item	Date of Completion or Anticipated Completion
The Company completes a forensic investigation into the Suspicious Transactions	The Forensic Accountant completed the forensic investigation and submitted its final investigation report to the Special Committee on March 26, 2019
The Special Committee concludes its formal investigation and, with the assistance of its professional advisors, completes its final report summarizing the key findings of the formal investigation and submits the same to the Board for consideration	The Special Committee delivered its final report to the Board on March 27, 2019
The Board meets to consider and, if deemed appropriate, approve the Special Committee's final report and the Trading Resumption Plan	The Board adopted and approved the Special Committee's final report and the key findings set out therein on March 30, 2019
The Company announces the material findings of the Special Committee in respect of the Suspicious Transactions that were investigation pursuant to the Formal Investigation and the Trading Resumption Plan	The Company announced the material findings of the Special Committee in respect of the Suspicious Transactions that were investigation pursuant to the Formal Investigation and the Trading Resumption Plan on March 30, 2019
The Company announces its financial results for the fiscal year ended December 31, 2018	The Company announced its 2018 fiscal year results on March 31, 2019
The Special Committee, with the assistance of its professional advisors, completes its assessment of the potential remedial actions and preventative measures available to the Company to address the issues which caused the Trading Suspension and prepares a report on its conclusions and recommendations for the Board. The Board considers the recommendations of the Special Committee and formalizes and approves a set of remedial actions and preventative measures	The Special Committee expects to deliver its report and recommendations to the Board, and the Board anticipates that it will be in a position to approve specific remedial actions and preventative measures, on or before April 30, 2019
The Company applies to the HKEX and the TSX for trading in the Common Shares to resume	The Company anticipates submitting an application to the HKEX and the TSX as soon as practicable after the Board has formally approved a set of remedial actions and preventative measures
The Company announces the remedial actions and preventative measures approved by the Board and the resumption of trading on the HKEX and the TSX	As soon as practicable after the HKEX and the TSX accepts the Company's application for trading resumption

The Trading Resumption Plan set forth above was approved by the Board based on the information and advice received as of March 30, 2019 and may be subject to change. In accordance with Rule 13.24A of the HKEX's Listing Rules, the Company will announce details of any material changes to the Trading Resumption Plan (including any delays thereof) as and when necessary.

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

1. Overview continued

Significant Events and Highlights continued

- ***Restatement of Prior Year Financial Information*** – Based on the key findings of and information obtained from the Formal Investigation, the Company has considered the resulting financial impact on the Financial Statements and determined that a restatement of prior period financial information is required. The restatements reflect the impact of the misappropriation of assets as well as the reclassification of certain balances of assets in the prior years. In particular, certain prepaid contracts recognized in 2016 were fictitious as the services were never to be received by the Company and accordingly no assets should have been recognized. Further, in 2016 there was embezzlement of bank acceptances. Consequently, in these financial statements there is no impairment related to these assets to be recorded in 2017. The net effect was an increase in the net comprehensive loss of 2016 of $4.8 million and decrease of the net comprehensive loss of $2.1 million in 2017. A summary of the requisite adjustments on the Financial Statements for the years ended 2016 and 2017 is set forth in the table below:

$ in thousands **Statement of financial position extract**	December 31, 2017	Increase/ (decrease)	**December 31, 2017 (Restated)**	December 31, 2016	Increase/ (decrease)	**January 1, 2017 (Restated)**
Trade and other receivables	$ 16,486	$ 4,648	**$ 21,134**	$ 19,434	$ –	**$ 19,434**
Notes receivables	12,520	(10,622)	**1,898**	–	–	**–**
Prepaid expenses and deposits	6,286	(1,157)	**5,129**	8,194	(4,797)	**3,397**
Deferred revenue	(27,644)	4,419	**(23,225)**	(29,849)	–	**(29,849)**
Net assets	$ 10,540	$ (2,712)	**$ 7,828**	$ 46,013	$ (4,797)	**$ 41,216**
Exchange reserve	(4,737)	(342)	**$ (5,079)**	(5,158)	–	**$ (5,158)**
Accumulated deficit	(1,135,809)	(2,370)	**(1,138,179)**	(1,095,788)	(4,797)	**(1,100,585)**
Total equity	$ 10,540	$ (2,712)	**$ 7,828**	$ 46,013	$ (4,797)	**$ 41,216**

$ in thousands **Statement of comprehensive income extract**	December 31, 2017	Loss decrease/ (increase)	**December 31, 2017 (Restated)**
Other operating expenses	$ (11,264)	$ 2,137	**$ (9,127)**
Finance costs	(22,958)	290	**(22,668)**
Net loss attributable to equity holders of the Company	$ (40,021)	$ 2,427	**$ (37,594)**
Other comprehensive income for the year	421	(342)	**79**
Net comprehensive loss attributable to equity holders of the Company	$ (39,600)	$ 2,085	**$ (37,515)**

Basic and diluted loss per share for the year ended December 31, 2017 has also been restated. The correction for both basic and diluted loss per share was from a loss of $0.15 to a loss of $0.14.

The amounts disclosed above for the 2017 reporting period, and for the statements of financial position as at January 1, 2017 and December 31, 2017 are before restatements for the change in accounting policy disclosed in Note 30 of the Company's consolidated financial statements for the year ended December 31, 2018.

1. Overview continued

Significant Events and Highlights continued

- ***Suspension of the Ceke Logistic Park Development*** – As part of its focus on capital preservation, the Company intends to suspend indefinitely all further development activities relating to the previously announced Ceke Logistics Park Project until further notice.

- ***Restrictions on Importing F-Grade Coal into China*** – As a result of import restrictions established by Chinese authorities at the Ceke border, the Company has been barred from transporting its F-grade coal products into China for sale since December 15, 2018. The Company, together with other Mongolian coal companies, have been in discussions with Chinese authorities regarding a potential amendment or withdrawal of these import restrictions to allow for the importation of F-grade coal into China; however, there can be no assurance that a favorable outcome will be reached.

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

  Mr. Zhiwei Chen: Mr. Chen was appointed as a non-executive director on April 13, 2018.

  Mr. Xiaoxiao Li: Mr. Li was appointed as a non-executive director on April 13, 2018.

  Mr. Shougao Wang: Mr. Wang was appointed as Chief Executive Officer on June 1, 2018 and was subsequently appointed as an executive director on July 3, 2018.

  Mr. Weiguo Zhang: Mr. Zhang was appointed as Chief Financial Officer on June 1, 2018.

  Mr. Aiming Guo: Mr. Guo was appointed as Chief Operating Officer on June 1, 2018.

  Mr. Bing Wang: Mr. Wang stepped down as interim Chief Executive Officer and returned to his prior position as General Manager, Sales and Marketing of the Company on June 1, 2018. Subsequently on August 26, 2018, Mr. Wang ceased to be the General Manager, Sales and Marketing of the Company.

  Mr. Yulan Guo: Mr. Guo ceased to be the Chief Financial Officer of the Company and an executive director on June 1, 2018. Mr. Guo did not stand for re-election at the Company's annual general meeting of shareholders (the "AGM") held on June 28, 2018 ("2018 AGM") and ceased to be a non-executive director.

  Mr. Aminbuhe: On June 28, 2018, Mr. Aminbuhe did not stand for re-election at the 2018 AGM and ceased to be a non-executive director.

  Mr. Zhu Liu: On June 28, 2018, Mr. Liu did not stand for re-election at the 2018 AGM and ceased to be an Independent non-executive director.

  Ms. Lan Cheng: On June 28, 2018, Ms. Cheng was elected as a non-executive director of the Company at the 2018 AGM.

  Mr. Tao Zhang: Mr. Zhang was appointed as a vice president of the Company on July 3, 2018.

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

1. Overview continued

Significant Events and Highlights continued

- ***Going Concern*** – Since 2016, the Company has been developing plans to change its 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 at the Ovoot Tolgoi mine was completed, and operations at the wash plant commenced, in October 2018. The Company sold 0.2 million tonnes of washed coal in the fourth quarter of 2018. The Company is in the process of making improvements to the wash plant in order to enhance the operational efficiency, as well as the output throughput. The Company is currently in discussions with the wash plant operator concerning an agreement regarding the operation of the wash plant; however, there can be no assurance that a favorable outcome will be reached.

  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 to be undertaken in 2019 and 2020 and the Company to make 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, 2019, 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 31, 2019, the Company had $8.7 million of cash.

2. Selected Annual Information

$ in thousands, except per share and per tonne information	Year ended December 31, 2018	2017 (Restated)	2016 (Restated)
Revenue	**$ 103,804**	$ 120,973	$ 58,450
Loss from operations	**(10,534)**	(14,637)	(42,904)
Net loss	**(41,125)**	(37,594)	(65,643)
Basic and diluted loss per share	**$ (0.15)**	$ (0.14)	$ (0.25)
Cash from operating activities	**40,420**	25,731	2,761
Cash used in investing activities	**(26,656)**	(18,686)	(1,530)
Cash used in financing activities	**(13,649)**	(1,661)	(579)
Coal sales volumes *(millions of tonnes)* [(i)]	**2.78**	4.65	3.91
Average realized selling price *(per tonne)*	**$ 37.12**	$ 28.31	$ 16.44

$ in thousands	As at December 31, 2018	2017 (Restated)	2016 (Restated)
Cash and cash equivalents	**$ 6,959**	$ 6,471	$ 966
Total working capital deficiency	**(203,083)**	(169,033)	(64,222)
Total assets	**227,606**	253,436	254,524
Total non-current liabilities	**6,882**	5,554	96,706

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

Despite the constraints on capital which it experienced in 2016, the Company experienced an increase in coal sales volume to 3.9 million tonnes in 2016. Although the average selling price remained challenged throughout 2016, the Company expanded its sales network and increased the number of customers from 5 in 2015 to 19 in 2016.

The Company experienced an increase in the average selling price of coal from $16.4 per tonne for 2016 to $28.3 for 2017. Despite the delays in the customs clearance process at the Ceke border which the Company has been experiencing since July 2017, the volume of coal sales increased from 3.9 million tonnes for 2016 to 4.7 million tonnes from 20 customers for 2017.

Although total sales volume dropped for 2018, the Company was able to preserve its capital and improve its financial results as a result of tighter cost control measures, as well as achieving a higher average selling price of coal. Loss from operations for 2018 has been reduced by more than 28% when compared to 2017, while the average selling price of coal increased by more than 31% during the same time horizon.

3. Overview of Operational Data and Financial Results

Summary of Annual Operational Data

		Year ended December 31, 2018		2017
Sales Volumes, Prices and Costs				
Premium semi-soft coking coal				
Coal sales *(millions of tonnes)*		**0.59**		0.86
Average realized selling price *(per tonne)*	**$**	**50.34**	$	47.84
Standard semi-soft coking coal/premium thermal coal				
Coal sales *(millions of tonnes)*		**1.26**		2.44
Average realized selling price *(per tonne)*	**$**	**37.61**	$	28.72
Standard thermal coal				
Coal sales *(millions of tonnes)*		**0.78**		1.35
Average realized selling price *(per tonne)*	**$**	**25.07**	$	15.24
Washed coal				
Coal sales *(millions of tonnes)*		**0.15**		–
Average realized selling price *(per tonne)*	**$**	**44.02**	$	–
Total				
Coal sales *(millions of tonnes)*		**2.78**		4.65
Average realized selling price *(per tonne)*	**$**	**37.12**	$	28.31
Raw coal production *(millions of tonnes)*		**4.34**		6.38
Cost of sales of product sold *(per tonne)*	**$**	**28.72**	$	22.77
Direct cash costs of product sold *(per tonne)* [(i)]	**$**	**10.31**	$	9.32
Mine administration cash costs of product sold *(per tonne)* [(i)]	**$**	**1.50**	$	2.80
Total cash costs of product sold *(per tonne)* [(i)]	**$**	**11.81**	$	12.12
Other Operational Data				
Production waste material moved *(millions of bank cubic meters)*		**18.16**		20.79
Strip ratio *(bank cubic meters of waste material per tonne of coal produced)*		**4.17**		3.26
Lost time injury frequency rate [(ii)]		**0.05**		0.18

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

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

Overview of Annual Operational Data

As at December 31, 2018, the Company had a lost time injury frequency rate of 0.05 per 200,000 man hours based on a rolling 12-month average.

The Company experienced an increase in the average selling price of coal in 2018 from $28.3 per tonne in 2017 to $37.1 per tonne in 2018, which was mainly as a result of a combination of the following: a higher proportion of sales made through IMSGE in 2018, and an improved product mix. The product mix for 2018 consisted of approximately 21% of premium semi-soft coking coal, 46% of standard semi-soft coking coal, 28% of thermal coal and 5% of washed coal compared to approximately 19% of premium semi-soft coking coal, 52% of standard semi-soft coking coal and 29% of thermal coal in 2017.

Sales volume decreased from 4.7 million tonnes in 2017 to 2.8 million tonnes in 2018, which was mainly as a result of the delays experienced in the customs clearance process at the Ceke border which the Company has been experiencing since July 2017, as well as the decreased production level for 2018.

3. Overview of Operational Data and Financial Results continued

Overview of Annual Operational Data continued

The Company's production in 2018 was lower than 2017 as a result of an increase in strip ratio for 2018 and a focus on capital preservation, yielding 4.3 million tonnes for 2018 as compared to 6.4 million tonnes for 2017.

The Company's unit cost of sales of product sold increased to $28.7 per tonne in 2018 from $22.8 per tonne in 2017. The increase was mainly driven by decreased sales volume and the related diseconomies of scale, as well as the reclassification of royalties during the fourth quarter of 2018.

Summary of Annual Financial Results

		Year ended December 31,		
		2018		2017
$ in thousands, except per share information				(Restated)
Revenue [(i)]	**$**	**103,804**	$	120,973
Cost of sales [(i)]		**(79,835)**		(105,858)
Gross profit excluding idled mine asset costs [(ii)]		**36,829**		27,747
Gross profit		**23,969**		15,115
Other operating expenses		**(23,607)**		(9,127)
Administration expenses		**(10,540)**		(9,181)
Evaluation and exploration expenses		**(356)**		(273)
Impairment of property, plant and equipment		**–**		(11,171)
Loss from operations		**(10,534)**		(14,637)
Finance costs		**(28,578)**		(22,668)
Finance income		**184**		164
Share of earnings of a joint venture		**1,631**		1,287
Income tax expense		**(3,828)**		(1,740)
Net loss		**(41,125)**		(37,594)
Basic and diluted loss per share	**$**	**(0.15)**	$	(0.14)

(i) 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.

(ii) A non-IFRS financial measure, idled mine asset costs represents the depreciation expense relates to the Company's idled plant and equipment.

Overview of Annual Financial Results

The Company recorded a $10.5 million loss from operations in 2018 compared to a $14.6 million loss from operations in 2017 (Restated). The operations for 2018 were impacted by the following factors: (i) improved coal prices; (ii) the Company recognizing a provision for doubtful trade and other receivables of $20.9 million; and (iii) the Company recognizing an impairment of coal stockpile inventories of $5.4 million. The recognition of provisions for doubtful notes receivables and trade and other receivables follows after a credit reassessment carried out during the second quarter of 2018 which concluded with the Company only continuing coal deliveries to customers with above-standard credit ratings in order to preserve the capital of the Company and discontinuing coal deliveries to certain other customers. The provisions relate to receivables from those former customers to whom the Company has ceased coal shipments. The Company will continue to explore different options to recover the balance of these doubtful trade and notes receivables; however, there are no assurances that the Company will be successful in recovering all, or any portion of such balances.

3. Overview of Operational Data and Financial Results continued

Overview of Annual Financial Results continued

Revenue was $103.8 million in 2018 compared to $121.0 million in 2017. The Company's revenue is presented after deduction of royalties in 2017 but the royalties were classified as cost of sales starting from the fourth quarter of 2018. The Company's effective royalty rate for 2018, based on the Company's average realized selling price of $37.1 per tonne, was 7.9% or $3.0 per tonne, compared to 5.8% or $1.7 per tonne in 2017 (based on the average realized selling price of $28.3 per tonne in 2017).

Royalty expenses were $8.2 million in 2018 compared to $7.7 million in 2017; the increase was mainly due to a larger provision for royalty expenses being recorded for the balance during the year.

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 including transportation costs to the Mongolia border. If such transportation costs have not been included in the contract, the relevant transportation costs, customs 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 the section entitled "*Risk Factors – Company's Projects in Mongolia*".

Cost of sales was $79.8 million in 2018 compared to $105.9 million in 2017. The decrease in cost of sales in 2018 was mainly due to the Company recognizing coal stockpile impairments of $17.0 million in 2017 as compared to $5.4 million in 2018, as well as the decreased sales during 2018. Cost of sales consists of operating expenses and royalties, 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, 2018		2017
Operating expenses	$	**41,068**	$	55,451
Share-based compensation expense		**4**		30
Depreciation and depletion		**20,466**		20,719
Impairment of coal stockpile inventories		**5,437**		17,026
Cost of sales from mine operations		**66,975**		93,226
Cost of sales related to idled mine assets		**12,860**		12,632
Cost of sales	$	**79,835**	$	105,858

Operating expenses in cost of sales were $41.1 million in 2018 compared to $55.5 million in 2017. The overall decrease in operating expenses was primarily due to the decreased sales volume from 4.7 million tonnes in 2017 to 2.8 million tonnes in 2018.

Cost of sales in 2018 and 2017 included coal stockpile impairments of $5.4 million and $17.0 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.

3. Overview of Operational Data and Financial Results continued

Overview of Annual Financial Results continued

Cost of sales related to idled mine assets in 2018 included $12.9 million related to depreciation expenses for idled equipment (2017: $12.6 million). Cost of sales consists of 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.

Other operating expenses were $23.6 million in 2018 (2017 (Restated): $9.1 million), as follows:

$ in thousands	Year ended December 31, 2018	2017 (Restated)
Reversal of provision/(provision) for doubtful trade and other receivables	**$ (20,892)**	$ 682
CIC management fee	**(2,697)**	–
Impairment of properties for resale	**(2,239)**	(1,718)
Provision for commercial arbitration	**(124)**	(2,384)
Impairment of prepaid expenses and deposits	**(134)**	(380)
Penalty on late settlement of trade payables	**(427)**	–
Loss on disposal of properties for resale	**(179)**	–
Gain on settlement of trade payables	**2,392**	–
Gain on disposal of property, plant and equipment	**994**	–
Foreign exchange loss	**(643)**	(1,116)
Net reversal of impairment of items of property, plant and equipment	**346**	–
Mining services, net	**–**	(2,395)
Underprovision of miscellaneous taxes	**–**	(1,421)
Other	**(4)**	(395)
Other operating expenses	**$ (23,607)**	$ (9,127)

The Company made a provision for doubtful trade and other receivables of $20.9 million in 2018 (2017: negligible) for certain long aged receivables based on its expected credit loss model and challenges in collecting the receivables.

Administration expenses were $10.5 million in 2018 as compared to $9.2 million in 2017, as follows:

$ in thousands	Year ended December 31, 2018	2017
Corporate administration	**$ 2,639**	$ 2,534
Professional fees	**2,685**	2,464
Salaries and benefits	**5,004**	3,726
Share-based compensation expense	**75**	89
Depreciation	**137**	368
Administration expenses	**$ 10,540**	$ 9,181

Administration expenses were higher for 2018 compared to 2017 primarily due to higher legal and professional fees and salaries incurred during the year. The increase in salaries and benefits was mainly due to the increase of headcount.

Evaluation and exploration expenses were $0.4 million and $0.3 million in 2018 and 2017, respectively. The Company continued to minimize evaluation and exploration expenditures in 2018 in order to preserve the Company's financial resources. Evaluation and exploration activities and expenditures in 2018 were limited to ensuring that the Company met the Mongolian Minerals Law requirements in respect of its mining licenses.

3. Overview of Operational Data and Financial Results continued

Overview of Annual Financial Results continued

Finance costs were $28.6 million and $22.7 million in 2018 and 2017 (Restated), respectively, which primarily consisted of interest expense on the $250.0 million CIC Convertible Debenture.

Summary of Quarterly Operational Data

	2018				2017			
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)*	**0.24**	0.25	0.07	0.03	0.37	0.12	0.18	0.19
Average realized selling price *(per tonne)*	**$ 47.37**	$ 48.15	$ 59.98	$ 67.94	$ 50.47	$ 46.55	$ 45.67	$ 45.61
Standard semi-soft coking coal/premium thermal coal								
Coal sales *(millions of tonnes)*	**0.40**	0.26	0.19	0.41	0.60	0.41	0.79	0.64
Average realized selling price *(per tonne)*	**$ 32.60**	$ 34.40	$ 33.80	$ 46.34	$ 37.49	$ 28.32	$ 26.69	$ 23.36
Standard thermal coal								
Coal sales *(millions of tonnes)*	**0.12**	0.22	0.32	0.12	0.29	0.27	0.51	0.28
Average realized selling price *(per tonne)*	**$ 24.26**	$ 23.49	$ 26.32	$ 25.40	$ 16.98	$ 14.48	$ 15.79	$ 13.17
Washed coal								
Coal sales *(millions of tonnes)*	**0.15**	–	–	–	–	–	–	–
Average realized selling price *(per tonne)*	**$ 44.02**	$ –	$ –	$ –	$ –	$ –	$ –	$ –
Total								
Coal sales *(millions of tonnes)*	**0.91**	0.73	0.58	0.56	1.26	0.80	1.48	1.11
Average realized selling price *(per tonne)*	**$ 37.32**	$ 35.77	$ 32.81	$ 43.02	$ 36.54	$ 26.41	$ 25.24	$ 24.52
Raw coal production *(millions of tonnes)*	**1.87**	1.11	0.98	0.38	0.51	2.47	1.89	1.51
Cost of sales of product sold *(per tonne)*	**$ 36.19**	$ 20.99	$ 26.00	$ 29.48	$ 23.54	$ 31.31	$ 18.50	$ 21.40
Direct cash costs of product sold *(per tonne)* [i]	**$ 8.73**	$ 7.41	$ 10.12	$ 16.86	$ 9.91	$ 10.98	$ 7.84	$ 9.42
Mine administration cash costs of product sold *(per tonne)* [i]	**$ 2.19**	$ 1.24	$ 1.00	$ 1.23	$ 4.92	$ 2.98	$ 2.22	$ 1.01
Total cash costs of product sold *(per tonne)* [i]	**$ 10.92**	$ 8.65	$ 11.12	$ 18.09	$ 14.83	$ 13.96	$ 10.06	$ 10.43
Other Operational Data								
Production waste material moved *(millions of bank cubic meters)*	**5.54**	4.56	5.18	2.88	4.36	6.77	6.36	3.30
Strip ratio (bank cubic meters of waste material per tonne of coal produced)	**2.97**	4.11	5.26	7.55	8.59	2.74	3.37	2.18
Lost time injury frequency rate [ii]	**0.00**	0.00	0.06	0.13	0.20	0.23	0.18	0.11

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

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

3. Overview of Operational Data and Financial Results continued

Overview of Quarterly Operational Data

For the fourth quarter of 2018, the Company had a lost time injury frequency rate of 0.00 per 200,000 man hours based on a rolling 12-month average.

The average selling price achieved by the Company for the fourth quarter of 2018 was similar to the fourth quarter of 2017 (Fourth quarter of 2018: $37.3 per tonne; fourth quarter of 2017: $36.5 per tonne). The Company's product mix has improved as a result of the commissioning of the wash plant in the fourth quarter of 2018. The product mix for the fourth quarter of 2018 consisted of approximately 27% of premium semi-soft coking coal, 44% of standard semi-soft coking coal, 13% of thermal coal and 16% of washed coal, compared to approximately 30% of premium semi-soft coking coal, 47% of standard semi-soft coking coal and 23% of thermal coal for the fourth quarter of 2017.

The Company sold 0.9 million tonnes for the fourth quarter of 2018 as compared to 1.3 million tonnes for the fourth quarter of 2017.

The Company's production in the fourth quarter of 2018 was higher than the fourth quarter of 2017 as a result of management's decision to pace production to meet expected sales as well as a lower strip ratio achieved for the quarter, yielding 1.9 million tonnes for the fourth quarter of 2018 as compared to 0.5 million tonnes for the fourth quarter of 2017.

The Company's unit cost of sales of product sold increased to $36.2 per tonne in the fourth quarter of 2018 from $23.5 per tonne in the fourth quarter of 2017. The increase was mainly driven by decreased sales volume and the related diseconomies of scale, as well as the reclassification of royalties in the fourth quarter of 2018.

Summary of Quarterly Financial Results

The Company's annual 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	**2018**				2017			
Quarter Ended	**31-Dec**	30-Sep (Restated)	30-Jun (Restated)	31-Mar (Restated)	31-Dec (Restated)	30-Sep (Restated)	30-Jun	31-Mar
Financial Results								
Revenue [i]	**$ 38,717**	$ 24,487	$ 17,377	$ 23,223	$ 41,698	$ 19,356	$ 34,665	$ 25,254
Cost of sales [i]	**(32,930)**	(15,320)	(15,078)	(16,507)	(29,665)	(25,049)	(27,385)	(23,759)
Gross profit/(loss) excluding idled mine asset costs	**7,305**	13,195	6,079	10,250	15,682	(2,094)	9,445	4,714
Gross profit/(loss) including idled mine asset costs	**5,787**	9,167	2,299	6,716	12,033	(5,693)	7,280	1,495
Other operating income/(expenses)	**(2,921)**	(3,417)	(16,512)	(757)	(4,971)	3,097	(4,045)	(3,208)
Administration expenses	**(1,583)**	(2,724)	(3,856)	(2,377)	(2,111)	(2,451)	(2,234)	(2,385)
Evaluation and exploration expenses	**(36)**	(40)	(156)	(124)	(52)	(48)	(144)	(29)
Impairment of property, plant and equipment	**–**	–	–	–	(11,171)	–	–	–
Profit/(loss) from operations	**1,247**	2,986	(18,225)	3,458	(6,272)	(5,095)	857	(4,127)
Finance costs	**(10,899)**	(5,758)	(5,958)	(6,006)	(5,960)	(5,674)	(5,494)	(5,715)
Finance income	**13**	106	8	100	143	142	50	4
Share of earnings of a joint venture	**416**	247	628	340	368	265	388	266
Income tax credit/(expense)	**(1,023)**	(267)	(1,609)	(929)	781	238	(2,714)	(45)
Net loss	**(10,246)**	(2,686)	(25,156)	(3,037)	(10,940)	(10,124)	(6,913)	(9,617)
Basic and diluted loss per share	**$ (0.04)**	$ (0.01)	$ (0.09)	$ (0.01)	$ (0.04)	$ (0.04)	$ (0.03)	$ (0.04)

(i) 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.

3. Overview of Operational Data and Financial Results continued

Overview of Quarterly Financial Results

The Company recorded a $1.2 million profit from operations in the fourth quarter of 2018 compared to a $6.3 million loss from operations in the fourth quarter of 2017 (Restated). The overall financial results have improved when compared to the fourth quarter of 2017, which was principally attributable to the Company recognizing a lower amount of impairment charges and provisions during the fourth quarter of 2018 as compared to the fourth quarter in 2017. During the fourth quarter of 2017, a specific impairment charge of $11.2 million was made on deposits related to certain purchases of property, plant and equipment (2018: $nil) and $2.4 million of provisions were made in connection with the Arbitration Award involving First Concept (2018: $nil).

Revenue was $38.7 million in the fourth quarter of 2018 compared to $41.7 million in the fourth quarter of 2017. The Company's revenue was presented after deduction of royalties in 2017 but the royalties were classified as cost of sales starting from the fourth quarter of 2018. Royalty expenses for the quarter were $3.3 million, compared to $2.7 million for the fourth quarter of 2017, the increase was mainly due to a larger provision for royalty expenses being recorded for the balance during the quarter.

Cost of sales was $32.9 million in the fourth quarter of 2018 compared to $29.7 million in the fourth quarter of 2017. The increase in cost of sales was mainly due to the reclassification of royalty expenses during the fourth quarter of 2018 of $8.2 million. Excluding the effect of this reclassification, the cost of sales during the quarter dropped which is in line with the decrease in sales during the quarter. Cost of sales consists of operating expenses, royalties, 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 quarter.

$ in thousands	Three months ended December 31, **2018**		2017	
Operating expenses	**$**	**18,173**	$	18,695
Share-based compensation expense		**3**		–
Depreciation and depletion		**7,799**		3,429
Impairment of coal stockpile inventories		**5,437**		3,892
Cost of sales from mine operations		**31,412**		26,016
Cost of sales related to idled mine assets		**1,518**		3,649
Cost of sales	**$**	**32,930**	$	29,665

Operating expenses in cost of sales were $18.2 million in the fourth quarter of 2018 compared to $18.7 million in the fourth quarter of 2017. The overall decrease in operating expenses was primarily due to the effect of: (i) lower unit costs achieved through improvement of operational efficiency; and (ii) decreased sales volume from 1.3 million tonnes in the fourth quarter of 2017 to 0.9 million tonnes in the fourth quarter of 2018, which was partially offset by the reclassification of royalties of $8.2 million during the fourth quarter of 2018.

Cost of sales in the fourth quarter of 2018 included coal stockpile impairments of $5.4 million (fourth quarter of 2017: $3.9 million), to reduce the carrying value of the Company's coal stockpiles to their net realizable value. The coal stockpile impairments recorded in the fourth quarter of 2018 primarily related to the Company's higher-ash content products as a result of import restrictions established by Chinese authorities at the Ceke border.

Cost of sales related to idled mine assets in the fourth quarter of 2018 included $1.5 million related to depreciation expenses for idled equipment (fourth quarter of 2017: $3.6 million).

3. Overview of Operational Data and Financial Results continued

Overview of Quarterly Financial Results continued

Other operating expenses was $2.9 million in the fourth quarter of 2018 (fourth quarter of 2017 (Restated): $5.0 million). Upon the disposal of certain property, plant and equipment during the quarter, the Company recorded a gain of $2.2 million in the fourth quarter of 2018 (fourth quarter of 2017: $nil).

$ in thousands	Three months ended December 31, 2018	2017 (Restated)
Reversal of provision/(provision) for doubtful trade and other receivables	**$ (1,588)**	$ 629
Impairment of properties for resale	**(866)**	(643)
Impairment of prepaid expenses and deposits	**(134)**	–
CIC management fee	**(1,360)**	–
Foreign exchange loss	**(1,373)**	(1,139)
Loss on disposal of properties for resale	**(179)**	–
Gain on disposal of property, plant and equipment	**2,167**	–
Reversal of provision/(provision) for commercial arbitration	**562**	(2,384)
Net reversal of impairment of items of property, plant and equipment	**346**	–
Adjustment on gain on settlement of trade payables	**(564)**	–
Underprovision of miscellaneous taxes	**–**	(1,421)
Other	**68**	(13)
Other operating expenses	**$ (2,921)**	$ (4,971)

Administration expenses were $1.6 million in the fourth quarter of 2018 as compared to $2.1 million in the fourth quarter of 2017. The increase in salaries and benefits was mainly due to the increase of headcount.

$ in thousands	Three months ended December 31, 2018	2017
Corporate administration	**$ 308**	$ 603
Professional fees	**52**	505
Salaries and benefits	**1,184**	891
Share-based compensation expense	**28**	22
Depreciation	**11**	114
Administration expenses	**$ 1,583**	$ 2,135

Evaluation and exploration expenses were negligible for the both the fourth quarter of 2018 and the fourth quarter of 2017. The Company continued to minimize evaluation and exploration expenditures in 2018 in order to preserve the Company's financial resources. Evaluation and exploration activities and expenditures in the fourth quarter of 2018 were limited to ensuring that the Company met the Mongolian Minerals Law requirements in respect of its mining licenses.

Finance costs were $10.9 million in the fourth quarter of 2018 compared to $6.0 million in the fourth quarter of 2017, which primarily consisted of interest expense on the CIC Convertible Debenture. The increase in finance costs was mainly due to the value added tax in relation to an intercompany loan arrangement.

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.

4. Non-IFRS Financial Measures continued

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 a substitute for measures of performance prepared in accordance with IFRS.

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, 2018 and December 31, 2017. 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, **2018**	2017	Year ended December 31, **2018**	2017
Cash costs				
Cost of sales determined in accordance with IFRS	**$ 32,930**	$ 29,665	**$ 79,835**	$ 105,858
Less royalties	**(8,237)**	–	**(8,237)**	–
Less non-cash expenses	**(13,239)**	(7,321)	**(25,907)**	(36,900)
Less non-cash idled mine asset costs	**(1,518)**	(3,649)	**(12,860)**	(12,632)
Total cash costs	**9,936**	18,695	**32,831**	56,326
Less idled mine asset cash costs	**–**	–	**–**	–
Total cash costs excluding idled mine asset cash costs	**9,936**	18,695	**32,831**	56,326
Coal sales *(millions of tonnes)*	**0.91**	1.26	**2.78**	4.65
Total cash costs of product sold *(per tonne)*	**$ 10.92**	$ 14.83	**$ 11.81**	$ 12.12

$ in thousands, except per tonne information	Three months ended December 31, **2018**	2017	Year ended December 31, **2018**	2017
Cash costs				
Direct cash costs of product sold *(per tonne)*	**$ 8.73**	$ 9.91	**$ 10.31**	$ 9.32
Mine administration cash costs of product sold *(per tonne)*	**2.19**	4.92	**1.50**	2.80
Total cash costs of product sold *(per tonne)*	**$ 10.92**	$ 14.83	**$ 11.81**	$ 12.12

The direct cash cost of product sold per tonne was $8.7 for the fourth quarter of 2018, which is similar to $9.9 per tonne for the fourth quarter 2017.

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. Some higher ash content product is being washed and sold as semi-soft coking coal products while some of the unwashed 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

A resource estimate for the Ovoot Tolgoi deposit is set out in 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

A reserve estimate for the Ovoot Tolgoi deposit is set out in 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.

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

5. Properties continued

Mining Operations continued

Transportation Infrastructure

On April 26, 2018, the Board of RDCC LLC increased the toll rate from MNT 1,200 per tonne of coal to MNT 1,500, effective from June 1, 2018.

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, 2018, RDCC LLC recognized toll fee revenue of $1.9 million (2017: $1.8 million) and $7.3 million (2017: $6.1 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 19 MT4400AC (218 tonne capacity) haul trucks, together with various pieces of ancillary equipment.

Workforce

As at December 31, 2018, SGS employed 444 employees in Mongolia. Of the 444 employees, 40 are employed in the Ulaanbaatar office, 2 in an outlying office and 402 at the Ovoot Tolgoi Mine site. Of the 444 employees based in Mongolia, 416 (94%) are Mongolian nationals and of those, 220 (50%) are residents of the local Gurvantes, Dalanzadgad, Sevrei and Noyon Soums.

Development Projects and Exploration Program

Soumber Deposit

The Soumber Deposit, comprising the Central Soumber, East Soumber, Biluut, South Biluut and Jargalant Fields, is located approximately 20km east of the Ovoot Tolgoi Mine (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.

5. Properties continued

Development Projects and Exploration Program continued

Soumber Deposit continued

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.

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.

5. Properties continued

Development Projects and Exploration Program continued

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 2018 in order to preserve the Company's financial resources. The 2019 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 London Interbank Offered Rate ("LIBOR") in effect plus 11% per annum; a commitment fee of 35% of the 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 August 29, 2018, the Company and Turquoise Hill entered into a deferral agreement (the "August 2018 Deferral Agreement"), whereby Turquoise Hill agreed to a limited deferral of repayment of all remaining amounts and obligations owing under the TRQ Loan to February 28, 2019 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) $0.1 million per month from August 2018 to September 2018; (ii) $0.2 million per month from October 2018 to January 2019; and (iii) the remaining balance on February 28, 2019 (the payments in (i), (ii) and (iii), the "Repayments"); and
- Interest shall continue to accrue on all outstanding obligations at the 12-month US dollar LIBOR.

Unless otherwise agreed by Turquoise Hill, under certain circumstances, including the non-payment of interest amounts as the same become due, amounts outstanding under the TRQ Loan may be accelerated. Bankruptcy and insolvency events with respect to the Company or its material subsidiaries will result in an automatic acceleration of the indebtedness under the TRQ Loan. Subject to notice and cure periods, certain events of default under the TRQ Loan will result in acceleration of the indebtedness under such loan at the option of Turquoise Hill.

6. Liquidity and Capital Resources continued

Liquidity and Capital Management continued

Turquoise Hill Loan Facility continued

As of the date hereof, the Company has not paid a portion of its February 2019 monthly payment. Pursuant to the terms of the TRQ Loan and the August 2018 Deferral Agreement, the Company is, as of the date of this MD&A, in default of its obligations under the TRQ Loan and the August 2018 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 August 2018 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 August 2018 Deferral Agreement.

As at December 31, 2018, the outstanding principal and accrued interest under this facility amounted to $nil and $0.7 million, respectively (December 31, 2017: the outstanding principal and accrued interest under this facility amounted to $1.0 million and $0.7 million, respectively). A fair value gain of $0.1 million was credited to accumulated deficit upon the adoption of IFRS 9 starting from January 1, 2018.

Equipment Loan

IMSGE executed a loan agreement on August 31, 2017 with subsequent amendments on July 9, 2018 and November 21, 2018 with a third party for the purpose of financing the purchase of mining equipment.

The Company repaid $1.2 million to the third party in November 2018 and, as of the date hereof, the Equipment Loan has been fully repaid.

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, 2018, the loan arrangement fee being amortized was negligible (2017: $nil).

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, SGS 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 matured on May 6, 2018 while the remaining balance of the principal amount of $0.7 million matured 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 were pledged as security (subsequently released upon repayment of loan principal of $2.3 million).

$2.3 million and $0.7 million of the loan principal was repaid to the Bank by the Company in May 2018 and January 2019, respectively, and the loan balance was fully settled.

6. Liquidity and Capital Resources continued

Liquidity and Capital Management continued

Bank Loan continued

On May 15, 2018, SGS and the Bank entered into another loan agreement with the key commercial terms as follows:

- Principal amount of the loan (the "2018 Bank Loan") of $2.8 million;
- Maturity date set at 24 months from drawdown;
- Interest rate of 15% per annum and interest is payable monthly; and
- Certain items of property, plant and equipment were pledged as security for both the Bank Loan and the 2018 Bank Loan. As at December 31, 2018, the net book value of the pledged items of property, plant and equipment was $2.6 million (December 31, 2017: $4.5 million).

As at December 31, 2018, the outstanding principal balance of the Bank Loan, together with the 2018 Bank Loan, was $3.5 million (December 31, 2017: $3.0 million) and the accrued interest owed by the Company was negligible (December 31, 2017: negligible).

Costs reimbursable to Turquoise Hill

Prior to the completion of a private placement with Novel Sunrise Investments Limited 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, 2018, 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 although no agreement has been reached between the Company and Turquoise Hill as of the date of this MD&A. 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 TRQ Reimbursable Amount.

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, 2019 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 deficiency in assets of $48.1 million as at December 31, 2018 compared to total equity of $7.8 million as at December 31, 2017 (Restated) while the working capital deficiency (excess current liabilities over current assets) reached $203.1 million as at December 31, 2018 compared to a working capital deficiency of $169.0 million as at December 31, 2017 (Restated). Included in the working capital deficiency at December 31, 2018 are significant obligations, which include the 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. Pursuant to the terms of CIC Convertible Debenture, the Company was required to pay $8.1 million, $7.9 million and $8.1 million of anniversary cash interest on November 19, 2017, May 19, 2018 and November 19, 2018, respectively.

The Company has been in discussions with CIC for a deferral of the Outstanding Cash Interest Payable and the PIK Interest Shares; 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.

The Company also has other current liabilities, which require settlement in the short-term, including: the $12.5 million balance of payable to First Concept under the Settlement Deed, the $0.7 million undiscounted balance of the TRQ Loan and $24.0 million of unpaid taxes payable by SGS to the Mongolian government.

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, 2017, as follows:

$ in thousands	As at December 31, **2018**	2017
Less than 1 month	**$ 34,927**	$ 20,664
1 to 3 months	**16,336**	16,132
3 to 6 months	**5,446**	8,825
Over 6 months	**42,867**	33,598
Total trade and other payables	**$ 99,576**	$ 79,219

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. Except as disclosed elsewhere in this MD&A, no such lawsuits or proceedings are pending as at March 31, 2019.

6. Liquidity and Capital Resources continued

Liquidity and Capital Management continued

Going concern considerations continued

Since 2016, the Company has been developing plans to change its 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 at the Ovoot Tolgoi mine was completed, and the wash plant commenced commissioning, in October 2018. The Company sold 0.2 million tonnes of washed coal in the fourth quarter of 2018. The Company is in the process of making improvements to the wash plant in order to enhance the operational efficiency, as well as the output throughput, of the wash plant. The Company is currently in discussions with the wash plant operator concerning an agreement regarding the operation of the wash plant; however, there can be no assurance that a favorable outcome will be reached.

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 to be undertaken in 2019 and 2020 and the Company to make 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, 2019, 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, the June 2017 Deferral Agreement and the TRQ Loan. 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. Pursuant to the terms of the TRQ Loan and the August 2018 Deferral Agreement, all of the outstanding obligations under the TRQ Loan are immediately due and payable to Turquoise Hill as of the date hereof. If CIC takes steps to enforce payment under the CIC Convertible Debenture and the June 2017 Deferral Agreement, this 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: (i) 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 payment of amounts outstanding under the CIC Convertible Debenture and the June 2017 Deferral Agreement; and (ii) has received no indication from Turquoise Hill of any intention to deliver a notice of default under the TRQ Loan.

6. Liquidity and Capital Resources continued

Liquidity and Capital Management continued

Going concern considerations continued

Factors that impact the Company's liquidity are being closely monitored and include, but are not limited to, Chinese economic growth, market prices of coal, production levels, operating cash costs, capital costs, exchange rates of currencies of countries where the Company operates and exploration and discretionary expenditures.

As at December 31, 2018 and December 31, 2017, the Company was not subject to any externally imposed capital requirements.

As at March 31, 2019, the Company had $8.7 million of cash.

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, 2018, 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.

At any time before the payment under the terms of the June 2017 Deferral Agreement 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, $7.9 million and $8.1 million of anniversary cash interest to CIC on November 19, 2017, May 19, 2018 and November 19, 2018, respectively. Pursuant to the CIC Convertible Debenture, the Company was also obligated to issue to CIC $4.0 million worth of PIK interest shares on November 19, 2017 and $4.0 million worth of PIK Interest Shares on November 19, 2018.

6. Liquidity and Capital Resources continued

Liquidity and Capital Management continued

CIC Convertible Debenture continued

As of the date of this MD&A, the Company: (i) has neither paid the Outstanding Cash Interest Payable nor issued the 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. Furthermore, the Common Shares have now been suspended from trading on the HKEX and TSX for a period of more than 5 trading days since December 17, 2018, which represents another event of default under the CIC Convertible Debenture. 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 payment of amounts outstanding under the CIC Convertible Debenture and the June 2017 Deferral Agreement.

The Company has been in discussions with CIC for a deferral of the Outstanding Cash Interest Payable and the PIK Interest Shares; however, there can be no assurance that a favorable outcome will be reached.

CIC has notified the Company that, as a condition for agreeing to any deferral, it will require: (i) that the mutual co-operation 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; and (ii) the contractual right to nominate additional nominees for appointment or election to the Board; however, the Company has not entered into any formal agreement to amend the Co-Operation Agreement as of the date hereof.

Under certain conditions, including the non-payment of interest amounts as the same become due or the Common Shares being suspended or halted from trading on any stock exchange for a period of longer than 5 trading days, 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, 2018, IAS 1 requires the Company to classify the entire balance of the CIC Convertible Debenture as a current liability as at December 31, 2018, notwithstanding the fact that CIC has not indicated any intention to deliver notice of default or accelerate the maturity of the CIC Convertible Debenture.

6. Liquidity and Capital Resources continued

Liquidity and Capital Management continued

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 was 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 were reserved for a future award.

On November 14, 2018, the Company executed the Settlement Deed with First Concept in respect of the Arbitration Award. The Settlement Deed provides for the full and final satisfaction of the Arbitration Award as well as the settlement of the issue of costs relating to the Arbitration and any other disputes arising out of the Coal Supply Agreement. Pursuant to the Settlement Deed, which provides for the full and final satisfaction of the Arbitration Award as well as the settlement of the issue of costs relating to the Arbitration and any other disputes arising out of the Coal Supply Agreement, SGS agreed to pay to First Concept the sum of $13.9 million, together with simple interest thereon at the rate of 6% per annum from November 1, 2018 until full payment, in 12 monthly installments commencing in November 2018. Provided that SGS complies with the terms of the Settlement Deed, First Concept agreed to waive its costs in connection with the Arbitration and Arbitration Award and interest for the period from January 4, 2018 to October 31, 2018.

As of the date hereof, the Company has not paid the November 2018 and January 2019 monthly payments due under the Settlement Deed. On March 5, 2019, SGS received a notice from First Concept claiming that the Company is default under the Settlement Deed and demanding payment of the full amount of the outstanding monthly payments due under the Settlement Deed by no later than March 11, 2019, otherwise First Concept intends to commence legal action against SGS pursuant to the Settlement Deed. The Company is consulting with its independent litigation counsel regarding this matter; however, as a default is only triggered under the Settlement Deed where there has been a failure to pay two or more consecutive monthly instalment payments, the Company is of the view that SGS is not in default under the Settlement Deed. In the event that First Concept commences legal action against SGS regarding this matter, the Company intends to take appropriate steps to respond to such legal proceedings in the best interests of the Company through independent litigation counsel which has been retained by the Company for this purpose.

As at December 31, 2018, the outstanding payables to First Concept amounted to $12.5 million (December 31, 2017: $13.9 million of provision).

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

6. Liquidity and Capital Resources continued

Cash Flow Highlights

	Year ended December 31,	
$ in thousands	**2018**	2017
Cash generated from operating activities	**$ 40,420**	$ 25,731
Cash used in investing activities	**(26,656)**	(18,686)
Cash used in financing activities	**(13,649)**	(1,661)
Effect of foreign exchange rate changes on cash	**373**	121
Increase in cash for the year	**488**	5,505
Cash balance, beginning of year	**6,471**	966
Cash balance, end of year	**$ 6,959**	$ 6,471

Cash generated from Operating Activities

The Company generated $40.4 million of cash in operating activities in 2018 compared to $25.7 million in 2017. This is primarily due to the increase in gross profit generated during the year.

Cash used in Investing Activities

The Company used $26.7 million of cash during of 2018 in investing activities compared to $18.7 million during 2017. In 2018, expenditures on property, plant and equipment totaled $34.1 million (2017: $20.9 million) and $2.2 million of dividend income was collected from RDCC LLC (2017: $2.0 million).

Cash used in Financing Activities

Cash used in financing activities was $13.7 million in 2018, which was principally attributable to the net repayment of interest bearing loans of $3.1 million (2017: $1.7 million) and refund of customers' deposits of $10.1 million (2017: $nil).

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, 2018, the Company's operating and capital commitments were:

	Within 1 year	2-3 years	Over 3 years	Total
As at December 31, 2018				
Capital expenditure commitments	$ 1,254	$ –	$ –	$ 1,254
Operating expenditure commitments	9,783	970	1,798	12,551
Commitments	**$ 11,037**	**$ 970**	**$ 1,798**	**$ 13,805**

Pursuant to an Investment and Collaboration Agreement dated April 2, 2016, the Company contracted with a third party contractor to construct and operate a wash plant at the Ovoot Tolgoi mine site. Under the terms of this Investment and Collaboration Agreement, the third party contractor was responsible for all capital costs related to the construction of the wash plant facility and operating the wash plant facility during the initial term of the agreement in return for the Company paying the third party contractor a fixed tolling fee for each ton of coal that was washed through the wash plant. The parties agreed to terminate the Investment and Collaboration Agreement on October 8, 2017, and are currently in discussions regarding terms for a new agreement. There can be no assurance, however, that a favorable outcome will be reached.

6. Liquidity and Capital Resources continued

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, 2018. The impairment indicators were the uncertainty of future coal prices in China and the lower than budgeted production.

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 prices, sales volumes, coal washing capacity, operating costs and life of mine coal production estimates as at December 31, 2018. The resulting FVLCTD was $165.7 million as at December 31, 2018 while the cash generating unit carrying value of the Company's Ovoot Tolgoi Mine was $135.4 million, resulting a headroom of $30.3 million.

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 reference to the mine plan;
- Life-of-mine coal production, strip ratio, capital costs and operating costs; and
- A post-tax discount rate of 11% based on an analysis of the market, country and asset specific factors.

Key sensitivities in the valuation model are as follows:

- For each 1% increase/(decrease) in the long term price estimates, the calculated fair value of the cash generating unit increases/(decreases) by approximately $17.3/(17.3) million;
- For each 1% increase/(decrease) in the post-tax discount rate, the calculated fair value of the cash generating unit (decreases)/increases by approximately $(9.8)/10.9 million;
- For each 1% increase/(decrease) in the cash mining cost estimates, the calculated fair value of the cash generating unit (decreases)/increases by approximately $(13.5)/13.5 million; and
- For each 1% increase/(decrease) in Mongolian inflation rate, the calculated fair value of the cash generating unit (decreases)/increases by approximately $(76.7)/66.3 million.

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, 2018. A decline of more than 1% in the long term price estimates, an increase of more than 2% in the post-tax discount rate, an increase of more than 2% in the cash mining cost estimates or an increase of 1% in Mongolian inflation rate may trigger an impairment charge on the cash generating unit. The Company believes that the estimates and assumptions incorporated in the impairment analysis are reasonable; however, the estimates and assumptions are subject to significant uncertainties and judgments.

6. Liquidity and Capital Resources continued

Financial Instruments

The fair value of financial assets and financial liabilities at amortized cost is determined in accordance with generally accepted pricing models based on discounted cash flow analysis or using prices from observable current market transactions. The fair value of all the financial instruments of the Company approximates their carrying value because of the demand nature or short-term maturity of these instruments, except for the fair values of trade and other payables, interest bearing borrowings, and provision for commercial arbitration and convertible debenture below their respective carrying amounts given the current financial condition of the Company as described under Section 6 of this MD&A under the heading entitled "*Liquidity and Capital Management*".

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

$ in thousands	As at December 31, 2018	2017 (Restated)
Financial assets		
Notes receivables	**$ 2,500**	$ 1,898
Cash	**6,959**	6,471
Restricted cash	**872**	–
Trade and other receivables	**5,046**	21,134
Total financial assets	**$ 15,377**	$ 29,503

$ in thousands	As at December 31, 2018	2017
Financial liabilities		
Fair value through profit or loss		
Convertible debenture – embedded derivatives	**$ 265**	$ 402
Other financial liabilities		
Trade and other payables	**99,576**	79,219
Provision for commercial arbitration	**12,508**	13,884
Interest-bearing borrowings	**4,251**	7,693
Convertible debenture – debt host and interest payable	**139,636**	115,972
Total financial liabilities	**$ 256,236**	$ 217,170

7. Regulatory Issues and Contingencies

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 (the "November 5, 2015 Ontario Court Decision") 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. The leave to appeal to the Supreme Court of Canada was dismissed in June 2018.

Counsel for the parties has appeared in a case conference before the motions judge. A procedure to fix the process and timing leading up to the trial of the action has been settled in broad terms including the favourable prospect of an early trial based to a large extent on the existing record. The details of the final process are being negotiated between counsel.

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, 2018 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 coal 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 this $18.5 million will be required to be paid. Accordingly, the Company has determined a provision for this matter at December 31, 2018 is not required.

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.

Notice of Legal Proceedings from a Former Customer

On September 20, 2018, the Company announced that IMSGE had received the Summons from the Ejinaqi Court in relation to a dispute over certain coal sales contracts with Xiyuan, a former customer of IMSGE.

According to the Summons, Xiyuan applied to the Ejinaqi Court claiming that IMSGE should repay a sum of RMB19.4 million (approximately $2.8 million) to Xiyuan, comprised of RMB19.1 million of coal prepayments and RMB0.3 million of interest. Xiyuan also claimed against FLM for joint liability of the above sums, as it alleged that FLM acted as an agent for IMSGE to receive coal prepayment and deliver coal on behalf of IMSGE.

Subsequently, on January 24, 2019, the Company received notice that the Ejinaqi Court rendered a judgement allowing an application by Xiyuan to voluntarily withdraw its lawsuit against IMSGE and FLM. Xiyuan's application cited a lack of evidence.

7. Regulatory Issues and Contingencies continued

Mongolian royalties

During 2017, the Company was ordered by the Mongolian tax authority to apply the "reference price" determined by the Government of Mongolia, as opposed to calculated sales price that is derived based on the actual contract price, in calculating the royalties payable to the Government of Mongolia. Although no official letter has been received by the Company in respect of this matter 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 the royalty will be sustained.

Restrictions on Importing F-Grade Coal into China

As a result of import restrictions established by PRC authorities at the Ceke border, the Company has been barred from transporting its F-grade coal products into China for sale since December 15, 2018. The Company, together with other Mongolian coal companies, have been in discussions with PRC authorities regarding a potential amendment or withdrawal of these import restrictions to allow for the importation of F-grade coal into China; however, there can be no assurance that a favorable outcome will be reached.

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.

8. Environment continued

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 and the Chief Operating Officer. The primary objective of the Health, Environment, Safety and Social Responsibility Committee is to assist the Board of Directors in fulfilling its oversight responsibilities by monitoring and reviewing performance, and recommending for approval policies and management systems, with respect to health, environmental, safety and social responsibility related matters affecting the Company. 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 27 of the Company's consolidated financial statements for the year ended December 31, 2018.

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 31, 2019, approximately 272.7 million Common Shares were issued and outstanding. There are also incentive share options outstanding to acquire approximately 4.7 million unissued Common Shares with exercise prices ranging from CAD$0.13 to CAD$0.92. There are no preferred shares outstanding.

As at March 31, 2019, to the best of the Company's knowledge:

- CIC holds a total of approximately 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 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 is 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, and which are designed with the objective of providing reasonable assurance that: (i) 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 (ii) unauthorized acquisition, use or disposition of assets that could have a material effect on the financial statements is prevented or detected in a timely manner.

As discussed in Section 1 of this MD&A entitled "Overview – Significant Events and Highlights – Restatement of Prior Year Financial Information", the Company has restated certain items in its statement of financial position as at December 31, 2017 and January 1, 2017 and statement of comprehensive income for the year ended December 31, 2017. The amounts of each adjustment and a reconciliation between the previously published statements of financial position and statement of comprehensive income have been presented in Section 1 of this MD&A entitled "Overview – Significant Events and Highlights – Restatement of Prior Year Financial Information".

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. 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. As of December 31, 2018, 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* ("NI 52-109"), were not effective due to the identification of certain material weaknesses as outlined below. Pursuant to NI 52-109, a "material weakness" is defined as a deficiency, or combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial report will not be prevented or detected on a timely manner.

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

Management identified the following material weaknesses relating to the design and effectiveness of the internal controls over financial reporting as of December 31, 2018:

a) inadequate "know your customer" procedures in relation to the intake of new customers and insufficient due diligence undertaken prior to granting credit to customers, which increased the Company's exposure to credit risk;

b) inadequate controls relating to the payment authorization and contract approval processes, which increased the risk of the Company entering into unauthorized or improper transactions;

c) insufficient segregation of duties which increased the risk of bad actors colluding to act in ways which are detrimental to the Company;

d) insufficient control of performing reconciliations of balances with customers or suppliers on a regular basis with documentation retained; and

e) lack of a centralized information technology function which increased the risk of non-compliance with Company established documentation retention requirements.

While the Company is currently in the process of enhancing the internal controls, below summarizes the action plans to be taken:

a) Revisit the organizational structure of the Company and make changes if necessary;

b) Reestablish the KYC procedure whereby credit is granted to customers at appropriate levels with only the proper authority;

c) Reestablish reconciliation procedures of balances with third parties on a regular basis and the corresponding documentation requirements;

d) Centralize the human resources and information technology functions and set up and relevant policies uphold at the group level;

e) Payment approval procedures and the contract signing procedures shall be enhanced; and

f) In-house internal audit function with reporting line to the parties in charge of governance of the Company and/or the Audit Committee should be set up.

Management is committed to remediating the material weaknesses in a timely manner, with appropriate oversight from the Audit Committee. Since the appointment of the new senior management team in June 2018, the Company has taken proactive steps to address the issues which gave rise to the Suspicious Transactions, including enhancing the Company's contractual approval matrix and strengthening the controls relating to the payment authorization and contract approval process.

The Special Committee, with the assistance of its professional advisors, is in the process of assessing the potential remedial actions and preventative measures available to the Company to address the issues which caused the Trading Suspension, which will include amendments to the Company's existing system of internal controls and risk management policies and procedures to improve and strengthen the Company's commitment to a culture of honesty, integrity and accountability and compliance with the highest standards of professional and ethical conduct, and such other actions as the Special Committee may consider necessary or appropriate to protect the Company's interests.

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

Because of their inherent limitations, internal controls over financial reporting can provide only reasonable assurance and may not prevent or detect misstatements due to error or fraud. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by individual acts, by collusion of two or more individuals or by unauthorized override of controls. 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.

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, 2018.

The following new IASB standards were adopted by the Company on January 1, 2018, refer to Section 9 of the MD&A for the quarter ended March 31, 2018 for details, which is available under the Company's profile on SEDAR at www.sedar.com.

IFRS 9	Financial Instruments
IFRS 15	Revenue from Contracts with Customers
Interpretation 22	Foreign Currency Transactions and Advance Consideration

Refer to Note 2.4 of the Company's consolidated financial statements of the year ended December 31, 2018 for information regarding the accounting judgments and estimates.

13. Recent Accounting Pronouncements

The standard 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, 2018, is disclosed below. The Company intends to adopt these standards, if applicable, when they become effective.

IFRS 16	Leases [(i)]

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

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.

As at December 31, 2018, the Company continues to be in the process of reviewing and assessing the effect IFRS 16 will have on our financial statements. The Company is currently in the process of identifying all existing operating leases and service contracts that will be considered in scope of IFRS 16. We have not yet begun calculating or reviewing lease balances under the requirements of IFRS 16, or evaluating any lease conclusions or quantitative impacts upon adoption. We will apply IFRS 16 as at January 1, 2019 by applying the modified retrospective approach and not restate balances for the comparative period.

There are no other IFRS Standards 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, 2019 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, the June 2017 Deferral Agreement 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";

- the Company has a working capital deficiency (excess current liabilities over current assets) of $203.1 million as at December 31, 2018;

- 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, 2018 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 $12.5 million outstanding amount payable to First Concept under the Settlement Deed, the $0.7 million undiscounted balance of the TRQ Loan and $24.0 million of unpaid taxes payable by SGS to the Mongolian government.

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.

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

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 Settlement Deed, the Company has not paid the November 2018 and January 2019 monthly payments due thereunder. On March 5, 2019, SGS received a notice from First Concept claiming that the Company is in default under the Settlement Deed and demanding payment of the full amount of the outstanding monthly payments due under the Settlement Deed by no later than March 11, 2019, otherwise First Concept intends to commence legal action against SGS pursuant to the Settlement Deed. The Company is consulting with its independent litigation counsel regarding this matter; however, as a default is only triggered under the Settlement Deed where there has been a failure to pay two or more consecutive monthly instalment payments, the Company is of the view that SGS is not in default under the Settlement Deed.

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 and the June 2017 Deferral Agreement. 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 2019, 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 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 to be undertaken in 2019 and 2020 and the Company to make 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 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, 2019, 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.

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

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;
- An adequate water supply to the mine site to permit the continued operations of the wash plant as planned;
- Achieving satisfactory yields from wet washing operations;
- Successful conversion of resources into reserves during the life of mine;
- Continued delays in the customs clearance process at the Ceke border;
- Continued ban on the import of F-grade coal products into China;
- Success in enhancing the operational efficiency and the output throughput of the of the wet wash plant; and
- Successful negotiations with the wash plant operator concerning an agreement regarding the operation of the wash plant.

14. Risk Factors continued

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

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. continued

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.

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, China, 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.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION 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. continued

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-025436 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.

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.

14. Risk Factors continued

Risks Relating to the Company's Projects in Mongolia continued

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.

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.

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

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 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.

As a result of import restrictions established by PRC authorities at the Ceke border, the Company has been barred from transporting its F-grade coal products into China for sale since December 15, 2018. The Company, together with other Mongolian coal companies, have been in discussions with PRC authorities regarding a potential amendment or withdrawal of these import restrictions to allow for the importation of F-grade coal into China; however, there can be no assurance that a favorable outcome will be reached. A protracted or indefinite ban on the import of the Company's F-grade coal products into China may 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 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 31, 2019, to the best of the Company's knowledge:

- 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 the 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, 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, 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.

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.

14. Risk Factors continued

Risks relating to the Company's business and industry continued

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. continued

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 including transportation costs to the Mongolia border. If such transportation costs have not been included in the contract, the relevant transportation costs, customs 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.

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.

- 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.

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 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.

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.

14. Risk Factors continued

Risks relating to the Company's business and industry continued

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.

The Company's future financial performance depends, in part, on the successful operation of the wash plant at the Ovoot Tolgoi Mine, which is subject to various risks

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 at the Ovoot Tolgoi mine was completed, and operations at the wash plant commenced, in October 2018.

Because the Company's current mine plan is predicated, in part, on incorporating a coal washing and process systems, the Company's future financial performance will depend on the successful operation of the wash plant at the Ovoot Tolgoi mine. The operating performance of the wash plant, and the related cost of operation and maintenance, may be adversely affected by a variety of risk factors, including, but not limited to, the following:

- Maintaining an adequate water supply and power supply to the mine site to permit the continued operations of the wash plant as planned;
- Achieving satisfactory yields from wet washing operations;
- The Company successfully enhancing the operational efficiency and the output throughput of the of the wet wash plant;
- The Company successfully negotiating an agreement with the wash plant operator regarding the operation of the wash plant;
- Unexpected maintenance and replacement expenditures;
- Shutdowns due to the breakdown or failure of the wash plant's equipment;
- Labour disputes; and
- Catastrophic events such as fires, explosions, severe storms or similar occurrence affecting the wash plant facility or third parties providing services to the wash plant.

Any of the risks noted above could have a material adverse impact on the operational performance or cost of operations of the wash plant, which in turn could have a material adverse effect on the Company's financial performance, cash flow and results of operations.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF 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 customs 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 customs 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

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

The Company has 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 at the Ovoot Tolgoi mine was completed, and operations at the wash plant commenced, in October 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 to be undertaken in 2019 and 2020 and the Company to make 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, 2019, 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. The Company is currently in negotiations to finalize an agreement for a finance lease on the new wash plant facility.

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.

The Company has been selling its coal products since 2008. The Company had 20 active customers with the largest customer representing approximately 39%, the second largest customer representing approximately 18%, the third largest customer representing approximately 10%, the fourth largest customer representing approximately 6% and the remaining customers accounting for 27% of the Company's total sales for the year ended December 31, 2018. 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 Formal Investigation conducted by the Special Committee may reveal that the Company is exposed to potential liabilities. Failure by the Company to address the issues which caused the Trading Suspension could have adverse consequences on the Company's business.

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. In November 2017, the Company formed a Special Committee to initiate a formal internal investigation into certain legal 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.

On December 17, 2018, the Company announced that it had learned of certain information relating to past conduct engaged in by Former Management and Employees which raised suspicions of serious fraud, misappropriation of Company assets and other criminal acts by the Former Management and Employees relating to prior transactions between 2016 and the first half of 2018 involving the Company, IMSGE and certain coal trading and transportation companies, some of which are allegedly related to or controlled by the Former Management and Employees or their related persons. The Company filed a report with local police authorities in China in respect of certain of the Suspicious Transactions and, on December 17, 2018, the Board expanded the mandate of the Special Committee to include a formal investigation of the Suspicious Transactions, the implicated Former Management and Employees, and their impact, if any, on the business and affairs of the Company. The Special Committee engaged Blake, Cassels & Graydon LLP as independent Canadian legal counsel, Zhong Lun Law Firm, as independent Chinese legal counsel, and Ernst & Young (China) Advisory Limited, as forensic accountants, to assist in the formal investigation.

On March 30, 2019, the Company announced that the Special Committee concluded the Formal Investigation and delivered a final report summarizing its key findings to the Board, which was adopted and approved at a meeting held on March 30, 2019. A summary of the material findings of the Special Committee in respect of the Suspicious Transaction that were investigation pursuant to the Formal Investigation is set out in Section 1 of this MD&A entitled "Overview – Significant Events and Highlights – Key Findings of Formal Investigation".

As of the date of this MD&A, the Special Committee, with the assistance of its professional advisors, is in the process of assessing the potential remedial actions and preventative measures available to the Company to address the issues which caused the Trading Suspension, which will include amendments to the Company's existing system of internal controls and risk management policies and procedures to improve and strengthen the Company's commitment to a culture of honesty, integrity and accountability and compliance with the highest standards of professional and ethical conduct, and such other actions as the Special Committee may consider necessary or appropriate to protect the Company's interests.

Failure by the Company to implement appropriate remedial actions and preventative measures to address the issues which caused the Trading Suspension may have a material adverse impact on the Company's business, reputation, financial performance and results of operations. Such failure may also adversely affect the Company's ability to satisfy the conditions necessary to resume trading of the Common Shares on the TSX and HKEX, which would negatively affect the price and volatility of the Common Shares and any investment in such shares could suffer a significant decline.

14. Risk Factors continued

Risks relating to the Company's business and industry continued

Failure to maintain an effective system of internal controls may result in material misstatements of the Company's financial statements or cause the Company to fail to meet its reporting obligations or fail to prevent fraud.

Effective internal controls are necessary for the Company to provide reliable financial reports and prevent fraud. If the Company fails to maintain an effective system of internal controls, the Company may not be able to report its financial results accurately or prevent fraud; and in that case, Shareholders and investors could lose confidence in the Company's financial reporting, which would harm the Company's business and could negatively impact the price of the Common Shares.

As of December 31, 2018, the Chief Executive Officer and Chief Financial Officer of the Company have each concluded that, as of December 31, 2018, the Company's disclosure controls and procedures, as defined in NI 52-109, were not effective due to the identification of certain material weaknesses. Please see Section 11 of this MD&A entitled "Disclosure Controls and Procedures and Internal Controls Over Financial Reporting". If the Company fails to remedy these material weaknesses in its internal controls and procedures, or having corrected such material weaknesses, thereafter fails to maintain the adequacy of its internal controls and procedures, the Company could be the subject of regulatory scrutiny, penalties or litigation, all of which would harm the Company's business and could negatively impact the price of the Common Shares.

The Company cannot provide assurances that the Company will not experience potential material weaknesses in its internal controls. Even if the Company concludes that its internal controls over financial reporting provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with IFRS, because of their inherent limitations, internal control over financial reporting may not prevent or detect fraud or misstatements. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by individual acts, by collusion of two or more individuals or by unauthorized override of controls. Failure to implement required new or improved controls, or difficulties encountered in their implementation, could harm the Company's results of operations or cause the Company to fail to meet its future reporting obligations.

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.

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

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 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. As part of its focus on capital preservation, the Company has decided to suspend indefinitely all further development activities relating to the previously announced Ceke Logistics Park Project until further notice. The Company may be at risk of becoming subject to litigation proceedings initiated by its investment partner in the Ceke Logistics Park Project for failing to comply with the underlying agreements governing project development. Due to the inherent uncertainty of the litigation process, the resolution of any particular legal proceeding to which the Company may become subject could have a material adverse impact on its business, operations, results of operations, financial condition and future prospects.

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

Foreign currency fluctuations could affect expenses and any future earnings.

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

14. Risk Factors continued

Risks relating to the Company's business and industry continued

As of the date of this MD&A, the Common Shares are suspended from trading on the HKEX and TSX, and there is no assurance that trading of the Common Shares on either stock exchange will resume in the future.

As of the date of this MD&A, the Common Shares are suspended from trading on the TSX and that trading on the TSX will remain suspended until clarification regarding the business and affairs of the Company is announced. Trading in the Common Shares is also suspended on the HKEX pending the publication of an insider information announcement and compliance with the conditions set out in the resumption guidance issued by the HKEX. See Section 1 of this MD&A under the heading entitled "*Overview – Significant Events and Highlights – Trading Suspension on HKEX and TSX*".

There are no assurances that the Company will be able to remedy the issues causing the Trading Suspension and the Common Shares will resume trading on the TSX, the HKEX or both stock exchanges. A prolonged suspension in the trading of the Common Shares will put the Common Shares at risk of being delisted from trading on either the TSX or the HKEX. Pursuant to Rule 6.01A(1) of the HKEX's Listing Rules, the HKEX may cancel the listing of any securities that have been suspended from trading for a continuous period of 18 months. In the case of the Company, this 18 month period expires on June 16, 2020. Pursuant to Listing Rules 6.01 and 6.10, the HKEX also has the right to impose a shorter specific remedial period, where appropriate.

If trading of the Common Shares does not resume, or the Common Shares are delisted from trading, on the TSX, the HKEX or both stock exchanges, it will have a material adverse impact on the ability of Shareholders to dispose of, or obtain a quotation for, the Common Shares because there will be no public market for the Common Shares, and the value of the Common Shares will be material adversely impacted.

Furthermore, if the Common Shares are delisted from trading on the TSX or the HKEX, there is no assurance that the Company will attempt or be able to re-list the Common Shares on the TSX, the HKEX or another stock exchange.

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 the 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

The Company believes that coal will continue to be the primary energy source which China will rely on in the foreseeable future, as coal has supported more than half of China's total energy consumption in recent years. However, growth in the demand for coal in China is expected to decline gradually in the long run for the following reasons: (i) increased adoption and utilization of clean energy; (ii) the implementation of stricter safety and environmental rules and regulations; and (iii) total energy consumption growth rates are expected to decrease over time.

The Company believes that the future trend of the coal industry in China will involve coal companies placing an increased emphasis on improving the quality of their coal products through enhanced screening and washing procedures and mine management.

Looking forward to 2019, the Company remains cautiously optimistic regarding the Chinese coal market. The expected benefit from the reduced supply of low quality coal and increased railway transportation capacity in China are anticipated to be offset by the uncertain Chinese macroeconomic environment.

The Company's objectives for 2019 and the medium term are as follows:

- **Enhance product mix** – The Company will focus on improving the product mix and increase production of higher quality coal by (i) washing lower quality coal in the Company's coal wash plant; and (ii) improving mining operations and employing better mining technique and equipment.
- **Expand customer base** – The Company will endeavor to increase sales volume, expand its sales network, strengthen its sales and logistics capabilities and diversify its customer base.
- **Increase production and optimize cost structure** – The Company will aim to increase coal production volume to take advantage of economies of scale. The Company will also focus on reducing its production cost and optimizing its cost structure through innovation, training and productivity enhancement.
- **Progress growth options** – Subject to available financial resources, the Company plans to further the development of the Soumber Deposit in the medium term, while complying with all government requirements in relation to its licenses and agreements.
- **Operate in a socially responsible manner** – The Company will continue to maintain the highest standards in health, safety and environmental performance in a corporate socially responsible manner.

Going forward, the Company will continue to focus on creating shareholders value by leveraging its key competitive strengths, including:

- **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** – The Ovoot Tolgoi Deposit has mineral reserves of 114.1 million tonnes, while the aggregate coal resources include measured and indicated mineral resources of 194.6 million tonnes and inferred resources of 32.1 million tonnes.
- **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.
- **Bridge between Mongolia and China** – The Company is well positioned to capture the resulting business opportunities between China and Mongolia under the "One Belt, One Road" program. The Company will seek potential strategic support from its two largest shareholders (ie, CIC and Cinda), which are both state-owned-enterprises in China, and its strong operational record for the past twelve years in Mongolia, being one of the largest enterprises and taxpayers in Mongolia.

March 31, 2019

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 has established a Health, Environment, Safety and Social Responsibility Committee. The primary objective of the HESS Committee is to assist the Board of Directors in fulfilling its oversight responsibilities by monitoring and reviewing performance, and recommending for approval policies and management systems, with respect to health, environmental, safety and social responsibility related matters affecting the Company. The HESS Committee also reviews any incidents that occur and provides guidance on how to prevent any recurrences. During the course of 2018, the HESS Committee met three (3) times, and one of the HESS Committee meetings was held at the Ovoot Tolgoi mine site.

Annually, the HESS Committee reviews the Company's environmental, social and governance report (the "ESG Report") and provides guidelines and recommendations to the Company's management relating to the findings in the ESG Report. During the Financial Year, the HESS Committee reviewed its charter in light of current best practices.

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 0.05 per 200,000 man hours based on a rolling 12 month average in 2018. We 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 of Hong Kong Stock Exchange. 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 2018:

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.

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In 2018, the emissions of sulphur dioxide, nitrogen dioxide, respirable and fine suspended particles released through the mining process were within Mongolian air quality standard MNS 4585:2016. 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.

The results shown below demonstrates that our average results of the measured parameters were under the standard requirement for both 2017 and 2018.

	Measured parameters	Unit	Standard requirement	2017 average result	2018 average result
1	Dust content	mg/m^3	0.5	0.04	**0.102**
2	Sulphur Dioxide	mg/m^3	0.45	0.0215	**0.0335**
3	Nitrogen Dioxide	mg/m^3	0.085	0.0315	**0.0505**

Moreover, the Company has implemented a variety of environmental friendly waste management programs and is focused on recycling and reduction of wastes. In 2018, the Ovoot Tolgoi mine site generated 391 (2017: 311) tonnes of waste, including waste oil, used tires, car batteries and cartridges, and 70% (2017: 73%) 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:

			2017		**2018**	
	Measured parameters	**Unit**	Total consumption	Per tonne produced	**Total consumption**	**Per tonne produced**
1	Electricity	kWh	1,412,666	0.56	**1,692,828**	**0.56**
2	Gas (propane, oxygen, acetylene, argon, nitrogen)	Ballon/3000 psi	93	47.9 (per million tonnes)	**139**	**47.9 (per million tonnes)**
3	Oil (Gear oil, Hydraulic oil, Engine oil)	tonnes	107	30.2 (per million tonnes)	**165**	**30.2 (per million tonnes)**

– Water consumption

In 2018, the Ovoot Tolgoi mine site consumed 39,951m^3 (2017: 36,161m^3) of water for domestic use. In addition, 164,964m^3 (2017: 195,135m^3) of water, which is from nearby pit and water pond, was used for dust compression. In October 2018, the new coal wash plant at the Ovoot Tolgoi mine site had commenced operations, and 23,063m^3 of water was used for the coal washing process. Water consumption was lower in 2018 due to decreased 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.

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– **Energy use efficiency initiatives**

The Company utilizes the following measures to promote energy saving:

- conducts a routine camp meeting for all employees about energy use efficiency;
- erected signage to remind employees to turn off the lights when unused;
- the 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. During "World Water Day", we conducted a "Water and Cooperation" seminar at the mine site in collaboration with other nearby mining companies.

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 an 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 2017 and 2018 are as follows:

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

For 2018:

Heavy metals	Unit	Chromium	Lead	Cadmium	Nickel	Zinc
Average	**Mg/kg**	**37.5**	**36**	**0.4**	**26.5**	**40**
Maximum	**Mg/kg**	**82.3**	**141.3**	**1.9**	**55.3**	**134.5**
Minimum	**Mg/kg**	**2**	**2**	**0.06**	**12.2**	**19.3**
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. Commencing in 2008, the Company has carried out biological reclamation of a 53.86 hectare area and planted over 3,550 trees and shrubs to reduce greenhouse gas emissions. The Company organizes tree planting activities at Ovoot Tolgoi twice a year during the spring and the fall.

The Company is required by the Government of Mongolia to develop an environmental protection plan each year. The plan for 2019 has been approved by the Ministry of Environment and Green Development of Mongolia. Thirty seven 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 male and female employees. As of December 31, 2018, the Company had a workforce of 506 employees, including 114 female employees, representing 23% of the workforce. In 2018, the Company recruited 134 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 competitive employees, the Company has in place a 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$9.8 million to employees in 2018 (2017: US$8.0 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 2018.

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 13 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, 2018, the Company had a lost time injury frequency rate of 0.05 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 their position and that they are competent to perform those activities. All new employees, contractors and visitors to the 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 (2) 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 2018, safety training was provided for 3,695 employees (2017: 2,530) which includes new employee training, refresher training, contractor new employee training, contractor refresher training, visitor induction and trainings. A total of 22,424 training hours were given in 2018 (2017: 30,360 hours).

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.

B6: Product Responsibility

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

In 2018, the Company has produced 4.3 million tonnes of coal and has sold 2.8 million tonnes of coal to Customers. During the production, a total of 18.1 Mm^3 overburden was stripped, and the stripping coefficient was 4.17 m^3 per tonne. The Company actively promotes clean coal products, and we sell coal featuring low sulphur, low ash and high calorific value to Customers. In general, our coal products' average 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%, G index 58-62 and volatile matter at 32.9%

In October 2018, the new coal wash plant at the Ovoot Tolgoi mine site commenced operations, and it processes and washes coal with higher ash content which are sold as semi-soft coking coal products after being washed. We have processed 0.2 million tonnes of output coal at the coal wash plant in the fourth quarter of 2018 and sold 0.2 million tonnes of washed coal. The washed coal products average ash level at 13.6%, the average calorific value of 6,759 kcal/kg, the average Sulphur content was 0.95%, G index 58.4, volatile matter 32.9%. The Company is in the process of improving and enhancing the operation efficiency as we all as the output throughput of the wash plant. SouthGobi expects to utilize the wash plant to produce and sell higher volumes of higher-quality coal products to the Chinese market at improved margins going forward. The expected capacity of the coal wash plant is to process 1.8 million tonnes of input coal in a year.

B7: 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.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

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.

As of the date of this Annual Report, the Special Committee, with the assistance of its professional advisors, is in the process of assessing the potential remedial actions and preventative measures available to the Company to address the issues examined during the Formal Investigation, which will include amendments to the Company's existing system of internal controls and risk management policies and procedures to improve and strengthen the Company's commitment to a culture of honesty, integrity and accountability and compliance with the highest standards of professional and ethical conduct. For more information regarding the Formal Investigation and the material findings of the Special Committee in respect of the Suspicious Transactions that were investigated pursuant to the Formal Investigation, please see the section entitled "*Ad Hoc/Special Committees – Formal Investigation*" of the Corporate Governance Report.

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 is committed 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). As at December 31, 2018 the Company employed 444 employees in Mongolia, of which 416 (94%) are Mongolian nationals and of those, 220 (50%) 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 and development. Thus, the Company enjoys a good relationship with the local enterprises and government by supporting the local communities. For instance, the Company purchases 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.

In 2009, the Company implemented a scholarship program to support local students in the Gobi region, and, to-date, 130 scholarships have been granted to university students. In 2018, the Company awarded 20 scholarships, ten (10) of which were granted to students from the Gurvantes Soum region. The Company also builds infrastructures for the local communities, including the construction of a kindergarten in the Gurvantes Soum region in 2011. In 2017, the Company renovated the library at a secondary school in the Gurvantes Soum region. Following the renovation, the Company has continued to care for and maintain the library including the recent purchase of bestsellers to enrich the book collections.

Furthermore, each year, our Mongolian subsidiary SouthGobi Sands LLC hosts and sponsors sporting events and festivals for the local schools, and also co-organizes the English assessment exam, Olympiad. In 2018, the Company sponsored the Annual Cultural Festival, which was a concert to promote and preserve Mongolian traditional intangible cultural heritage, such as the Mongolian praises, epics, throat singing, and folk dances, etc. In addition, the campaign "A Good Book is a Good Friend" hosted by the Company together with the Central Library and the Office of Education and Culture of Umnugobi province was held successfully for the second year, which aims to encourage more people to read books and cultivate reading habits among students.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

The input and support that SouthGobi has contributed to the communities over the years has been acknowledged and recognized, and the Company has been honoured to receive various awards in the past years. In 2018, SouthGobi Sands LLC was recognized as a “Top 100 Companies” and ranked 25th of 100 top companies in Mongolia. Moreover, SouthGobi Sands LLC was also proud to receive one of its most prestigious awards, the “Best Occupational Hygiene and Safety Excellence” award during the year, which was presented by the Ministry of Labor and Social Protection. In addition, the Central Library of Umnugobi province recognized SouthGobi Sands LLC with the award “Book Friendly Company”. SouthGobi Sands LLC further received the “Best Employer of 2018” award by the Office of the Governor of Umnugobi province recognizing its contribution as a stable job provider in the province over the past ten years and half of its employees were recruited from the local areas. SouthGobi is proud and appreciative for all the recognition received and the Company will continue to contribute to the communities in every aspect it can.

During 2018, SouthGobi made US$76,445 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.


BUCYRUS

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.

CONSOLIDATED FINANCIAL STATEMENTS

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INDEPENDENT AUDITOR'S REPORT

To the Shareholders of SouthGobi Resources Ltd.

Our opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of SouthGobi Resources Ltd. and its subsidiaries (together, the Company) as at December 31, 2018 and 2017 and January 1, 2017, and its financial performance and its cash flows for the years ended December 31, 2018 and 2017 in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IFRS).

What we have audited

The Company's consolidated financial statements comprise:

- the consolidated statements of comprehensive income for the years ended December 31, 2018 and 2017;
- the consolidated statements of financial position as at December 31, 2018 and 2017 and January 1, 2017;
- the consolidated statements of changes in equity for the years ended December 31, 2018 and 2017;
- the consolidated statements of cash flows for the years ended December 31, 2018 and 2017; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

Basis for opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the "*Auditor's responsibilities for the audit of the consolidated financial statements*" section of our report.

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

Independence

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada. We have fulfilled our other ethical responsibilities in accordance with these requirements.

Material uncertainty related to going concern

We draw attention to Note 1 to 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. Our opinion is not modified in respect of this matter.

Emphasis of Matter – Restated Comparative Information

We draw attention to Note 2 to the consolidated financial statements, which explains that certain comparative information as at December 31, 2017 and January 1, 2017 and for the year ended December 31, 2017 has been restated. Our opinion is not modified in respect of this matter.

INDEPENDENT AUDITOR'S REPORT

Other information

Management is responsible for the other information. The other information comprises the Management's Discussion and Analysis, which we obtained prior to the date of this auditor's report and the information, other than the consolidated financial statements and our auditor's report thereon, included in the annual report, which is expected to be made available to us after that date.

Our opinion on the consolidated financial statements does not cover the other information and we do not and will not express an opinion or any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard. When we read the information, other than the consolidated financial statements and our auditor's report thereon, included in the annual report, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance.

Responsibilities of management and those charged with governance for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, 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.

In preparing the consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

INDEPENDENT AUDITOR'S REPORT

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor's report is Dean Larocque.

(signed) PricewaterhouseCoopers LLP
Chartered Professional Accountants
Vancouver, British Columbia
March 31, 2019

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

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

		Year ended December 31,	
	Notes	2018	2017 (Restated)
Revenue	5	**$ 103,804**	$ 120,973
Cost of sales	7	**(79,835)**	(105,858)
Gross profit		**23,969**	15,115
Other operating expenses	8	**(23,607)**	(9,127)
Administration expenses	9	**(10,540)**	(9,181)
Evaluation and exploration expenses		**(356)**	(273)
Impairment of property, plant and equipment	18	**–**	(11,171)
Loss from operations		**(10,534)**	(14,637)
Finance costs	10	**(28,578)**	(22,668)
Finance income	10	**184**	164
Share of earnings of a joint venture	19	**1,631**	1,287
Loss before tax		**(37,297)**	(35,854)
Current income tax expense	11	**(3,828)**	(1,740)
Net loss attributable to equity holders of the Company		**(41,125)**	(37,594)
Other comprehensive income/(loss) to be reclassified to profit or loss in subsequent periods			
Exchange difference on translation of foreign operation		**(13,020)**	79
Net comprehensive loss attributable to equity holders of the Company		**$ (54,145)**	$ (37,515)
Basic and diluted loss per share	12	**$ (0.15)**	$ (0.14)

Refer to note 2.3 for details regarding the restatement due to the misappropriation of assets as well as the reclassification of certain balances of assets and note 2.4 for details about restatements for changes in accounting policies.

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

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(expressed in thousands of U.S. Dollars)

	Notes	December 31, 2018	As at December 31, 2017 (Restated)	January 1, 2017 (Restated)
Assets				
Current assets				
Cash and cash equivalents		**$ 6,959**	$ 6,471	$ 966
Restricted cash		**872**	–	–
Trade and other receivables	13	**5,046**	21,134	19,434
Notes receivables	14	**2,500**	1,898	–
Inventories	16	**47,109**	36,389	28,583
Prepaid expenses and deposits	17	**3,295**	5,129	3,397
Total current assets		**65,781**	71,021	52,380
Non-current assets				
Property, plant and equipment	18	**138,901**	152,457	180,809
Properties for resale	15	**4,093**	8,906	–
Investment in joint ventures	19	**18,831**	21,052	21,335
Total non-current assets		**161,825**	182,415	202,144
Total assets		**$ 227,606**	$ 253,436	$ 254,524
Equity and liabilities				
Current liabilities				
Trade and other payables	20	**$ 99,576**	$ 79,219	$ 43,628
Deferred revenue	22	**12,658**	23,225	29,849
Provision for court case penalty		**–**	–	9,074
Provision for commercial arbitration	21	**12,508**	13,884	–
Interest-bearing borrowings	23	**4,221**	7,352	8,454
Current portion of convertible debenture	24	**139,901**	116,374	25,597
Total current liabilities		**268,864**	240,054	116,602
Non-current liabilities				
Interest-bearing borrowings	23	**30**	341	425
Convertible debenture	24	**–**	–	91,993
Decommissioning liability	25	**6,852**	5,213	4,288
Total non-current liabilities		**6,882**	5,554	96,706
Total liabilities		**275,746**	245,608	213,308
Equity				
Common shares	26	**1,098,634**	1,098,623	1,094,619
Share option reserve	28	**52,542**	52,463	52,340
Capital reserve	28	**396**	–	–
Exchange reserve		**(18,099)**	(5,079)	(5,158)
Accumulated deficit	26	**(1,181,613)**	(1,138,179)	(1,100,585)
Total equity/(deficiency in assets)		**(48,140)**	7,828	41,216
Total equity and liabilities		**$ 227,606**	$ 253,436	$ 254,524
Net current liabilities		**$ (203,083)**	$ (169,033)	$ (64,222)
Total assets less current liabilities		**$ (41,258)**	$ 13,382	$ 137,922

Corporate information and going concern (Note 1), commitments for expenditure (Note 33) and contingencies (Note 34)

Refer to note 2.3 for details regarding the restatement due to the misappropriation of assets as well as the reclassification of certain balances of assets and note 2.4 for details about restatements for changes in accounting policies.

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

APPROVED BY THE BOARD:

"Mao Sun"

Director

"Shougao Wang"

Director

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

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

	Number of shares/units	Share capital	Share option reserve	Capital reserve	Exchange fluctuation reserve	Accumulated deficit	Total
Restated balances, January 1, 2017	257,698	$ 1,094,619	$ 52,340	$ –	$ (5,158)	$ (1,100,585)	$ 41,216
Shares issued for:							
Interest settlement on convertible debenture	14,892	4,000	–	–	–	–	4,000
Employee share purchase plan	17	4	–	–	–	–	4
Share-based compensation credited to operations	–	–	123	–	–	–	123
Net loss for the year	–	–	–	–	–	(37,594)	(37,594)
Exchange differences on translation of foreign operations	–	–	–	–	79	–	79
Restated balances, December 31, 2017	272,607	$ 1,098,623	$ 52,463	$ –	$ (5,079)	$ (1,138,179)	$ 7,828
Restated balances, January 1, 2018	**272,607**	**$ 1,098,623**	**$ 52,463**	**$ –**	**$ (5,079)**	**$ (1,138,179)**	**$ 7,828**
Change in accounting policy due to IFRS 9	**–**	**–**	**–**	**–**	**–**	**(1,913)**	**(1,913)**
Restated balances, January 1, 2018	**272,607**	**$ 1,098,623**	**$ 52,463**	**$ –**	**$ (5,079)**	**$ (1,140,092)**	**$ 5,915**
Shares issued for:							
Employee share purchase plan	**96**	**11**	**–**	**–**	**–**	**–**	**11**
Share-based compensation charged to operations	**–**	**–**	**79**	**–**	**–**	**–**	**79**
Appropriation to capital reserve	**–**	**–**	**–**	**396**	**–**	**(396)**	**–**
Net loss for the year	**–**	**–**	**–**	**–**	**–**	**(41,125)**	**(41,125)**
Exchange differences on translation of foreign operations	**–**	**–**	**–**	**–**	**(13,020)**	**–**	**(13,020)**
Balances, December 31, 2018	**272,703**	**$ 1,098,634**	**$ 52,542**	**$ 396**	**$ (18,099)**	**$ (1,181,613)**	**$ (48,140)**

Refer to note 2.3 for details regarding the restatement due to the misappropriation of assets as well as the reclassification of certain balances of assets and note 2.4 for details about restatements for changes in accounting policies.

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Expressed in thousands of U.S. Dollars)

	Notes	Year ended December 31, 2018	2017 (Restated)
Operating activities			
Loss before tax		**$ (37,297)**	$ (35,854)
Adjustments for:			
Depreciation and depletion		**20,626**	29,355
Share-based compensation	27	**79**	123
Interest expense on convertible debenture	10	**22,195**	21,315
Interest expense on borrowings	10	**2,788**	1,103
Loan arrangement fee	10	**21**	90
Accretion of decommissioning liability	10	**536**	160
Finance income	10	**(184)**	(164)
Share of earnings of a joint venture	19	**(1,631)**	(1,287)
Interest paid		**(1,409)**	(19,432)
Income tax paid		**(3,374)**	(649)
Unrealized foreign exchange loss	8	**643**	276
Penalty on late settlement of trade payables	8	**427**	280
Loss/(gain) on disposal of fixed assets	8	**(994)**	27
Provision/(reversal of provision) for doubtful trade and other receivables	13	**20,892**	(682)
Provision for commercial arbitration	21	**124**	2,384
Impairment of prepaid expenses and deposits	17	**134**	380
Impairment of properties for resale	15	**2,239**	1,718
Loss on disposal of properties for resale	15	**179**	–
Gain on settlement of trade payables	8	**(2,392)**	–
Impairment of inventories	16	**5,437**	17,026
Impairment/(reversal of impairment) of property, plant and equipment	8	**(346)**	11,171
Operating cash flows before changes in non-cash working capital items		**28,693**	27,340
Net change in non-cash working capital items	32	**11,727**	(1,609)
Cash generated from operating activities		**40,420**	25,731
Investing activities			
Expenditures on property, plant and equipment		**(34,081)**	(20,816)
Investment in a new joint venture	19	**(9)**	–
Proceeds from disposal of property, plant and equipment		**5,193**	111
Interest received		**34**	28
Dividend from a joint venture	19	**2,207**	1,991
Cash used in investing activities		**(26,656)**	(18,686)
Financing activities			
Proceeds from issuance of common shares		**11**	4
Proceeds from loans		**2,800**	3,224
Loan arrangement fee paid		**–**	(21)
Repayment of interest-bearing loans		**(5,895)**	(4,868)
Refund of customers' deposits		**(10,565)**	–
Cash used in financing activities		**(13,649)**	(1,661)
Effect of foreign exchange rate changes on cash and cash equivalents		**373**	121
Increase in cash and cash equivalents		**488**	5,505
Cash and cash equivalents, beginning of year		**6,471**	966
Cash and cash equivalents, end of year		**$ 6,959**	$ 6,471

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 and options 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 for trading 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, 2018, to the Company's best knowledge, Land Breeze II S.à.r.l., a wholly-owned subsidiary of China Investment Corporation ("CIC") owned approximately 23.8% 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 owned approximately 17.0% and 9.5% of the outstanding common shares of the Company, respectively.

The Company owns the following significant coal project in Mongolia: the Ovoot Tolgoi open pit producing coal mine ("Ovoot Tolgoi Mine") and the following development projects, the Soumber Deposit, the Zag Suuj Deposit and the Ovoot Tolgoi Underground Deposit. These projects are located in the Umnugobi Aimag (South Gobi Province) of Mongolia, within 150 kilometers of each other and in close proximity to the Mongolia-China border. The Company owns a 100% interest in these coal projects.

The registered and records office of the Company is located at 20th Floor, 250 Howe Street, Vancouver, British Columbia, Canada, V6C 2G8. The principal place of business of the Company is located at Unit 1208-10, Tower One, 193 Prince Edward Road West, Grand Century Place, Mongkok, Kowloon, Hong Kong.

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, 2019 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 deficiency in assets of $48,140 as at December 31, 2018 compared to total equity of $7,828 as at December 31, 2017 (restated) while the working capital deficiency (excess current liabilities over current assets) reached $203,083 as at December 31, 2018 compared to a working capital deficiency of $169,033 as at December 31, 2017 (restated). Included in the working capital deficiency as at December 31, 2018 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"). Pursuant to the terms of CIC Convertible Debenture, the Company was required to pay $8,066, $7,934 and $8,066 of anniversary cash interest on November 19, 2017, May 19, 2018 and November 19, 2018, respectively (the "Anniversary Interest Payments" and together with the June 2017 Deferral Agreement Payment, the "Outstanding Cash Interest Payable"). Pursuant to the CIC Convertible Debenture, the Company was also obligated to issue to CIC $4,000 worth of payment in kind ("PIK") interest shares on November 19, 2017 and $4,000 worth of PIK interest shares on November 19, 2018 (collectively, the "PIK Interest Shares").

1. Corporate information and going concern continued

Going concern assumption continued

The Company has been in discussions with CIC for a deferral of the Outstanding Cash Interest Payable and the PIK Interest Shares; 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 a confidential partial ruling ("Arbitration Award") with respect to the commercial arbitration on January 10, 2018 involving SouthGobi Sands LLC ("SGS"), a subsidiary of the Company, and First Concept Industrial Group 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 November 14, 2018, the Company executed a deed of settlement (the "Settlement Deed") with First Concept. The Settlement Deed provides for the full and final satisfaction of the Arbitration Award as well as the settlement of the issue of costs relating to the Arbitration and any other disputes arising out of the Coal Supply Agreement. Pursuant to the Settlement Deed, SGS agreed to pay to First Concept the sum of $13,891 ("Settlement Sum"), together with simple interest thereon at the rate of 6% per annum from November 1, 2018 until full payment, in 12 monthly installments commencing in November 2018. Provided that SGS complies with the terms of the Settlement Deed, First Concept agreed to waive its costs in connection with the Arbitration and the interest for the period from January 4, 2018 to October 31, 2018. As of the date hereof, the Company has not paid the November 2018 and January 2019 monthly payments due under the Settlement Deed. On March 5, 2019, SGS received a notice from First Concept claiming that the Company is default under the Settlement Deed and demanding payment of the full amount of the outstanding monthly payments due under the Settlement Deed, otherwise First Concept intends to commence legal action against SGS pursuant to the Settlement Deed. The Company is consulting with its independent litigation counsel regarding this matter; however, as a default is only triggered under the Settlement Deed where there has been a failure to pay two or more consecutive monthly instalment payments, the Company is of the view that SGS is not in default under the Settlement Deed. In the event that First Concept commences legal action against SGS regarding this matter, the Company intends to take appropriate steps to respond to such legal proceedings in the best interests of the Company through independent litigation counsel which has been retained by the Company for this purpose. The Company repaid $1,500 to First Concept in 2018 (2017: $nil). As at December 31, 2018, the outstanding amount payable to First Concept amounted to $12,508 (2017: $13,884).

The Company also has other current liabilities, which require settlement in the short-term, including the $732 undiscounted balance of the Turquoise Hill Resources Limited ("Turquoise Hill") loan ("TRQ Loan") and $24,023 of unpaid taxes payable by SGS to the Mongolian government.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

1. Corporate information and going concern continued

Going concern assumption 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, 2017, as follows:

	As at December 31, 2018	2017
Less than 1 month	**$ 34,927**	$ 20,664
1 to 3 months	**16,336**	16,132
3 to 6 months	**5,446**	8,825
Over 6 months	**42,867**	33,598
Total trade and other payables	**$ 99,576**	$ 79,219

The Company may not be able to settle all trade and other payables on a timely basis, and as a result continuing postponement in settling the trade and other payables may impact the mining operations of the Company and may result in potential lawsuits and/or bankruptcy proceedings being filed against the Company. Except as disclosed elsewhere in this consolidated financial statement, no such lawsuits or proceedings are pending as at March 31, 2019.

Since 2016, the Company has been developing plans to change its 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 at the Ovoot Tolgoi mine was completed, and the wash plant commenced commissioning, in October 2018. The Company sold 0.2 million tonnes of washed coal in the fourth quarter of 2018. The Company is in the process of making improvements to the wash plant in order to enhance the operational efficiency, as well as the output throughput, of the wash plant. The Company is currently in discussions with the wash plant operator concerning an agreement regarding the operation of the wash plant; however, there can be no assurance that a favorable outcome will be reached.

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 to be undertaken in 2019 and 2020 and the Company to make 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, 2019, 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.

1. Corporate information and going concern continued

As of the date hereof, the Company is in default under the CIC Convertible Debenture, the June 2017 Deferral Agreement and the TRQ Loan. 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. Pursuant to the terms of the TRQ Loan and the August 2018 Deferral Agreement, all of the outstanding obligations under the TRQ Loan are immediately due and payable to Turquoise Hill as of the date hereof. If CIC takes steps to enforce payment under the CIC Convertible Debenture and the June 2017 Deferral Agreement, this 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 hereof, the Company has: (i) 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 payment of amounts outstanding under the CIC Convertible Debenture and the June 2017 Deferral Agreement; and (ii) has received no indication from Turquoise Hill of any intention to deliver a notice of default under the TRQ Loan.

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.

2. Basis of preparation

2.1 Statement of compliance

The consolidated financial statements, including comparatives, have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

The consolidated financial statements of the Company for the year ended December 31, 2018 were approved and authorized for issue by the Board of Directors of the Company on March 31, 2019.

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 30.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

2. Basis of preparation continued

2.3 Restatement of previously issued financial statements

On November 17, 2017, the Board formed a special committee of independent non-executive directors (the "Special Committee") to initiate a formal internal investigation into certain legal charges against Mr. Aminbuhe (the Company's former Chairman and Chief Executive Officer) and the connection, if any, between those charges and the Company and his conduct as Chairman and Chief Executive Officer of the Company.

On May 7, 2018, the Company provided an update on the status of its ongoing internal investigation into the charges against Mr. Aminbuhe, and reported that, to the best of its knowledge, the Chinese authorities had not laid charges against Mr. Aminbuhe, made any public statement of the basis for Mr. Aminbuhe's arrest or sought information from the Company in respect of this matter. The Company further reported that it was not aware of any definitive information which would suggest that Mr. Aminbuhe's arrest is related to any misconduct directly related to his position as Chairman and Chief Executive Officer of the Company.

On December 17, 2018, the Company announced that it had learned of certain information relating to past conduct engaged in by former senior executive officers and employees of the Company ("Former Management and Employees") which raised suspicions of serious fraud, misappropriation of Company assets and other criminal acts by the Former Management and Employees relating to prior transactions ("Suspicious Transactions") between 2016 and the first half of 2018 involving the Company, IMSGE and certain coal trading and transportation companies, some of which are allegedly related to or controlled by the Former Management and Employees or their related persons. The Company filed a report with local police authorities in China in respect of certain of the Suspicious Transactions and, on December 17, 2018, the Board expanded the mandate of the Special Committee to include a formal investigation (the "Formal Investigation") of the Suspicious Transactions, the implicated Former Management and Employees, and their impact, if any, on the business and affairs of the Company. The Special Committee engaged Blake, Cassels & Graydon LLP as independent Canadian legal counsel, Zhong Lun Law Firm, as independent Chinese legal counsel, and Ernst & Young (China) Advisory Limited, as forensic accountants, to assist in the formal investigation.

Based on the key findings of and information obtained from the Formal Investigation, the Company has considered the resulting financial impact on the Financial Statements and determined that a restatement of prior period financial information is required. The restatements reflect the impact of the misappropriation of assets as well as the reclassification of certain balances of assets in the prior years. In particular, certain prepaid contracts recognized in 2016 were fictitious as the services were never to be received by the Company and accordingly no assets should have been recognized. Further, in 2016 there was embezzlement of bank acceptances. Consequently, in these financial statements there is no impairment related to these assets to be recorded in 2017. The net effect was an increase in the net comprehensive loss of 2016 of $4,797 and decrease of the net comprehensive loss of $2,085 in 2017. A summary of the requisite adjustments on the Financial Statements for the years ended 2016 and 2017 is set forth in the table below:

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

2. Basis of preparation continued

2.3 Restatement of previously issued financial statements continued

Statement of financial position extract		December 31, 2017		Increase/ (decrease)		December 31, 2017 (Restated)		December 31, 2016		Increase/ (decrease)		January 1, 2017 (Restated)
Trade and other receivables	$	16,486	$	4,648	**$**	**21,134**	$	19,434	$	–	**$**	**19,434**
Notes receivables		12,520		(10,622)		**1,898**		–		–		**–**
Prepaid expenses and deposits		6,286		(1,157)		**5,129**		8,194		(4,797)		**3,397**
Deferred revenue		(27,644)		4,419		**(23,225)**		(29,849)		–		**(29,849)**
Net assets	$	10,540	$	(2,712)	**$**	**7,828**	$	46,013	$	(4,797)	**$**	**41,216**
Exchange reserve		(4,737)		(342)	**$**	**(5,079)**		(5,158)		–	**$**	**(5,158)**
Accumulated deficit		(1,135,809)		(2,370)		**(1,138,179)**		(1,095,788)		(4,797)		**(1,100,585)**
Total equity	$	10,540	$	(2,712)	**$**	**7,828**	$	46,013	$	(4,797)	**$**	**41,216**

Statement of comprehensive income extract		December 31, 2017		Loss decrease/ (increase)		December 31, 2017 (Restated)
Other operating expenses	$	(11,264)	$	2,137	**$**	**(9,127)**
Finance costs		(22,958)		290		**(22,668)**
Net loss attributable to equity holders of the Company	$	(40,021)	$	2,427	**$**	**(37,594)**
Other comprehensive income for the year		421		(342)		**79**
Net comprehensive loss attributable to equity holders of the Company	$	(39,600)	$	2,085	**$**	**(37,515)**

Basic and diluted loss per share for the year ended December 31, 2017 has also been restated. The correction for both basic and diluted loss per share was from a loss of $0.15 to a loss of $0.14.

The amounts disclosed above for the 2017 reporting period, and for the statements for financial position as at January 1, 2017 and December 31, 2017 are before restatements as described below for the change in accounting policy disclosed in Note 30.

2.4 Adoption of new and revised standards and interpretations

The following new IFRS standards and interpretations were adopted by the Company on January 1, 2018.

IFRS 9	Financial Instruments
IFRS 15	Revenue from Contracts with Customers
Interpretation 22	Foreign currency Transactions and Advance Consideration

IFRS 9, Financial Instruments (“IFRS 9”), 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 adopted IFRS 9 on a retrospective basis without restating prior period comparatives.

IFRS 9 requires financial assets to be classified as measured at fair value through profit and loss (FVTPL), fair value through other comprehensive income/loss (FVTOCI), or measured at amortized cost. As a result of the adoption of this standard, the Company has changed its accounting policy for financial assets. The Company’s cash and trade and other receivables, and notes receivables, were reclassified from loans and receivables to amortized cost.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

2. Basis of preparation continued

2.4 Adoption of new and revised standards and interpretations continued

For financial liabilities, the standard retains most of the International Accounting Standard ("IAS") 39 requirements except when there is a modification of the terms of any financial liability, non-substantial modifications do not result in derecognition. IFRS 9 requires the Company to recalculate the amortized cost of the modified financial liability by discounting the modified contractual cash flows using the original effective interest rate and recognizing any adjustment in profit or loss. The Company has had several past modifications of its CIC Convertible Debenture and the TRQ Loan. Therefore, on initial application of IFRS 9, due to the modification of the financial liabilities, $1,332 was recorded to increase the opening accumulated deficit and increase the carrying value of interest-bearing borrowings and convertible debenture upon the application of the transitional relief.

Additionally, the new impairment model requires the recognition of impairment provisions based on expected credit losses ("ECL") rather than only incurred credit losses as is the case under IAS 39. Therefore, on initial application of IFRS 9, $581 was recorded to increase the opening accumulated deficit and decrease the carrying value of the financial assets upon the application of the transitional relief. Please refer to Note 30 for details.

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 Company utilized the modified retrospective method for the adoption of IFRS 15. As a result of the transition to IFRS 15, royalties paid are no longer offset against revenue. As a result, the Company has presented its revenue on gross basis starting January 1, 2018. The Company produces coal products and the relevant performance obligations relate primarily to the delivery of the coal products to customers, with each delivery representing a separate performance obligation. In the year ended December 31, 2017 the total royalty expense netted against revenue was $7,653.

Revenue from the sale of coal product is recognized at the point the customer obtains control of the product, which is when the significant risks and rewards of ownership pass to the buyer and the Company has a present right to payment for the product.

Interpretation 22, Foreign Currency Transactions and Advance Consideration, clarifies how to determine the date of transaction for the exchange rate to be used on initial recognition of a related asset, expense or income where an entity pays or receives consideration in advance for foreign currency-denominated contracts.

For a single payment or receipt, the date of transaction should be the date on which the entity initially recognizes the non-monetary asset or liability arising from the advance consideration (the prepayment or deferred revenue).

If there are multiple payments or receipts for one item, a date of transaction should be determined as above for each payment or receipt. The Company chooses to apply the interpretation prospectively to items in scope that are initially recognized on or after the beginning of the reporting period in which the interpretation is first applied.

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

2. Basis of preparation continued

2.5 Standard issued but not yet effective

The IASB standard that is issued up to the date of issuance of the Company's financial statements, but was not effective during the year ended December 31, 2018, is disclosed below. The Company intends to adopt this standard on January 1, 2019.

IFRS 16	Leases

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.

As at December 31, 2018, the Company continues to be in the process of reviewing and assessing the effect IFRS 16 will have on our financial statements. The Company is currently in the process of identifying all existing operating leases and service contracts that will be considered in scope of IFRS 16. We have not yet begun calculating or reviewing lease balances under the requirements of IFRS 16, or evaluating any lease conclusions or quantitative impacts upon adoption. We will apply IFRS 16 as at January 1, 2019 by applying the modified retrospective approach and not restate balances for the comparative period.

There are no other IFRS Standards 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 major controlled subsidiaries (Note 31).

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 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

3. Summary of significant accounting policies continued

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 has 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.

Prior to January 1, 2018, the functional currency of the Company's Mongolian operations (SGS, Mazaalai Resources LLC, Mazaatt Holdings LLC and Dayarbulag LLC), was the United States Dollar. The functional currency of the Company's Chinese subsidiaries (SouthGobi Trading (Beijing) Co., Ltd., Inner Mongolia SouthGobi Energy Co., Ltd. ("IMSGE"), and Inner Mongolia SouthGobi Enterprise Co., Ltd.) was Renminbi ("RMB") and the functional currency for the Company's joint venture (RDCC LLC) was the Mongolian Tugrik ("MNT"). Per IAS 21 – The Effects of Changes in Foreign Exchange Rates, an entity's functional currency should be determined based on the underlying transactions, events and conditions relevant to the entity.

Determination of functional currency involves certain judgments to determine the primary economic environment and this is re-evaluated if events or conditions change. Based on management's re-evaluation, taking into consideration the primary economic environment in which the Mongolian operations carries on its business, management determined that the functional currency of the Mongolian operations changed from US dollars to MNT as at January 1, 2018 given the increased mining and administrative costs that are denominated in MNT.

The change in functional currency of the Mongolian operations was applied prospectively from January 1, 2018 in accordance with IAS 21. On the date of the change of functional currency, all items on the statement of financial position of the Mongolian operations were translated into MNT at the exchange rate on that date.

At the end of the reporting period, the assets and liabilities of an entity with the functional currency in a foreign currency 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.

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

3. Summary of significant accounting policies continued

3.6 Property, plant and equipment continued

Depreciation and depletion

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

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

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 and commercially viability.

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 that 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.

3. Summary of significant accounting policies continued

3.8 Development and production stripping costs

Once a property is determined to have reached technical feasibility and commercial viability, 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 cost 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.

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

3. Summary of significant accounting policies continued

3.11 Share-based payments continued

Equity-settled transactions

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

The cost 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.

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

3. Summary of significant accounting policies continued

3.14 Financial Instruments

The following accounting policies reflect the Company's adoption of IFRS 9 effective January 1, 2018. For the year ended December 31, 2017, the Company applied policies based on IAS 39. The effects of the transition from IAS 39 to IFRS 9 are described in the change in accounting policies section of note 2.4.

(a) Financial assets

All financial assets are initially recorded at fair value and categorized upon inception into one of the following categories: those to be measured subsequently at fair value either through other comprehensive income ("FVOCI") or through profit or loss ("FVTPL"), and those to be measured at amortized cost.

The classification depends on the entity's business model for managing the financial assets and the contractual terms of cash flows.

For assets measured at fair value, gains and losses will either be recorded in profit or loss or other comprehensive income. For investments in equity investments that are not held for trading, this will depend on whether the Company has made an irrevocable election at the time of initial recognition to account for the equity investment at FVOCI.

The Company reclassifies debt investments when and only when its business model for managing those assets changes.

Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest are measured at amortised cost. Interest income from these financial assets is included in finance income using the effective interest rate method. Any gain or loss arising on derecognition is recognised directly in profit or loss and presented in other gains/(losses) together with foreign exchange gains and losses. Impairment losses are presented as separate line item in the statement of profit or loss.

Assets that are held for collection of contractual cash flows and for selling the financial assets, where the assets' cash flows represent solely payments of principal and interest, are measured at FVOCI. Movements in the carrying amount are taken through other comprehensive income, except for the recognition of impairment gains or losses, interest income and foreign exchange gains and losses which are recognised in profit or loss. When the financial asset is derecognised, the cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to profit or loss and recognised in other gains/(losses). Interest income from these financial assets is included in finance income using the effective interest rate method. Foreign exchange gains and losses are presented in other gains/(losses) and impairment expenses are presented as separate line item in the statement of profit or loss.

Assets that do not meet the criteria for amortised cost or FVOCI are measured at FVTPL. A gain or loss on a debt investment that is subsequently measured at FVTPL is recognised in profit or loss and presented net within other gains/(losses) in the period in which it arises.

The Company's accounting policies for the financial assets prior to adoption of IFRS 9 as at January 1, 2018 were as follows:

3. Summary of significant accounting policies continued

3.14 Financial Instruments continued

(a) Financial assets continued

The Company categorized its financial assets in the following categories:

- financial assets at fair value through profit or loss,
- loans and receivables,
- held-to-maturity investments, and
- available-for-sale financial assets.

The classification depended on the purpose for which the investments were acquired. Management determined the classification of its investments at initial recognition and, in the case of assets classified as held-to-maturity, re-evaluated this designation at the end of each reporting period.

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

3. Summary of significant accounting policies continued

3.14 Financial Instruments continued

(b) Financial liabilities

Financial liabilities are categorized, at initial recognition, as financial liabilities at FVTPL, loans and borrowings, payables, or as derivatives designated as hedging instruments in an effective hedge, as appropriate.

All financial liabilities are recognised initially at fair value and, in case of loans and borrowings and payables, net of directly attributable costs.

Financial liabilities categorized as loans and borrowings are initially recognized at fair value less directly attributable transaction costs. After initial recognition, loans and borrowings 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. For liabilities designated at FVTPL, changes due to credit risk are recognized in other comprehensive income.

3.15 Impairment of financial assets

The Company's trade and other receivables and notes receivables are subject to IFRS 9's new ECL model.

The Company applies the IFRS 9 simplified approach to measuring expected credit losses, which uses a lifetime expected loss allowance for all trade receivables and notes receivables. The Company's definition of a default scenario is if receivables from a customer are over six months past due, or if there is reasonable and supportable evidence that a customer will no longer be able to settle its receivables with the Company. This resulted in an increase of the loss allowance on trade receivables by $19,078 during the current year. Please refer to note 30 for details.

Prior to the adoption of IFRS 9, under IAS 39, the Company assessed at the end of each reporting period whether a financial asset is impaired.

3. Summary of significant accounting policies continued

3.15 Impairment of financial assets continued

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.

3.16 Derecognition of financial assets and financial liabilities

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

3. Summary of significant accounting policies continued

3.17 Impairment of non-financial assets

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

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

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

3.18 Cash and cash equivalents

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

3.19 Revenue recognition

Prior to the adoption of IFRS 15, revenue was recognized to the extent it was probable that the economic benefits would flow to the Company and the revenue would be reliably measured. Revenue was measured at the fair value of the consideration received or receivable, excluding discounts, rebates or duties. Revenue from the sale of goods was recognized when the significant risks and rewards of ownership passed to the buyer, collection was reasonably assured and the selling price was reasonably determinable.

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

3.20 Provisions

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

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

3. Summary of significant accounting policies continued

3.21 Related party transactions

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

3.22 Significant accounting judgments and estimates

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

Liquidity and the going concern assumption

Management made a critical judgement that the Company will be able to continue operating until at least December 31, 2019 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. Refer to Note 1 for details.

As of the date hereof, the Company is in default under the CIC Convertible Debenture, the June 2017 Deferral Agreement and the TRQ Loan. Pursuant to the terms of the CIC Convertible Debenture and 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. Pursuant to the terms of the TRQ Loan and the August 2018 Deferral Agreement, all of the outstanding obligations under the TRQ Loan are immediately due and payable to Turquoise Hill as of the date hereof.

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 and the June 2017 Deferral Agreement. 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

3. Summary of significant accounting policies continued

3.22 Significant accounting judgments and estimates continued

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. These determinations and their individual assumptions require that management make a decision based on the best available information at each reporting period. Changes in these assumptions may alter the results of non-financial asset and financial asset impairment testing, impairment charges recognized in profit or loss and the resulting carrying amounts of assets.

Ovoot Tolgoi Mine cash generating unit

The Company determined that an indicator of impairment existed for its Ovoot Tolgoi Mine cash generating unit as at December 31, 2018. The impairment indicators were the uncertainty of future coal prices in China and the lower than budgeted production.

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 prices, sales volumes, washing production, operating costs and life of mine coal production estimates as at December 31, 2018. The resulting FVLCTD was $165,653 as at December 31, 2018 while the cash generating unit carrying value of the Company's Ovoot Tolgoi Mine was $135,410, resulting a headroom of $30,243.

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 reference to the mine plan;
- Life-of-mine coal production, strip ratio, capital costs and operating costs; and
- A post-tax discount rate of 11% based on an analysis of the market, country and asset specific factors.

3. Summary of significant accounting policies continued

3.22 Significant accounting judgments and estimates continued

Ovoot Tolgoi Mine cash generating unit continued

Key sensitivities in the valuation model are as follows:

- For each 1% increase/(decrease) in the long term price estimates, the calculated fair value of the cash generating unit increases/(decreases) by approximately $17,290/(17,290);
- For each 1% increase/(decrease) in the post-tax discount rate, the calculated fair value of the cash generating unit (decreases)/increases by approximately $(9,806)/10,895;
- For each 1% increase/(decrease) in the cash mining cost estimates, the calculated fair value of the cash generating unit (decreases)/increases by approximately $(13,501)/13,501; and
- For each 1% increase/(decrease) in Mongolian inflation rate, the calculated fair value of the cash generating unit (decreases)/increases by approximately $(76,733)/66,300.

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, 2018. A decline of more than 1% in the long term price estimates, an increase of more than 2% in the post-tax discount rate, an increase of more than 2% in the cash mining cost estimates or an increase of 1% in Mongolian inflation rate may trigger an impairment charge on the cash generating unit. The Company believes that the estimates and assumptions incorporated in the impairment analysis are reasonable; however, the estimates and assumptions are subject to significant uncertainties and judgments.

Expected credit losses for trade and other receivables

The Company applies the IFRS 9 simplified approach to measuring expected credit losses on its trade receivables and estimates expected credit loss based on the possible default events on its trade and other receivables. The Company has determined that the loss allowance on its trade and other receivables was $20,005 (2017: $697 which was not calculated under the ECL model) as at December 31, 2018.

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 and options in thousands, unless otherwise indicated)

3. Summary of significant accounting policies continued

3.22 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.

Estimated recoverable amount of F-grade coal

As a result of import restrictions established by Chinese authorities at the Ceke border, the Company has been barred from transporting its F-grade coal products into China for sale since December 15, 2018. The Company estimates the value of the F-grade coal inventory can be recovered upon the lifting of the import restrictions. Therefore, prolonged restrictions may impact the carrying value of the Company's F-grade coal inventory and an adjustment would need to be recognized in profit or loss. For the year ended December 31, 2018, an impairment of coal stockpile inventories of $5,437 was provided as a result.

Estimated additional royalty tax payable

During 2017, the Company was ordered by the Mongolian tax authority to apply the "reference price" determined by the Government of Mongolia, as opposed to calculated sales price that is derived based on the actual contract price, in calculating the royalties payable to the Government of Mongolia. Management believes that its interpretation of the relevant legislation is appropriate and the Company's positions related to the royalty will be sustained and the provision made for additional royalty tax payable is adequate.

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 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 and options in thousands, unless otherwise indicated)

4. Segmented information continued

During the year ended December 31, 2018, the Coal Division had 20 active customers with the largest customer accounting for 39% of revenues, the second largest customer accounting for 18% of revenues, the third largest customer accounting for 10% of revenues, the fourth largest customer accounting for 6% of revenues and the other customers accounting for the remaining 27% 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, 2018	$ 223,463	$ 4,406	$ 227,869
As at December 31, 2017 (Restated)	246,125	7,311	253,436
As at January 1, 2017 (Restated)	252,459	2,065	254,524
Segment liabilities			
As at December 31, 2018	$ 124,493	$ 151,516	$ 276,009
As at December 31, 2017 (Restated)	114,676	130,932	245,608
As at January 1, 2017	81,288	132,020	213,308
Segment loss			
For the year ended December 31, 2018	$ (16,523)	$ (24,602)	$ (41,125)
For the year ended December 31, 2017 (Restated)	(9,853)	(27,741)	(37,594)
Segment revenues			
For the year ended December 31, 2018	$ 103,804	$ –	$ 103,804
For the year ended December 31, 2017	120,973	–	120,973
Impairment charge on assets (ii)			
For the year ended December 31, 2018	$ 28,356	$ –	$ 28,356
For the year ended December 31, 2017 (Restated)	30,295	–	30,295
Depreciation and amortization			
For the year ended December 31, 2018	$ 36,668	$ 75	$ 36,743
For the year ended December 31, 2017	46,142	273	46,415
Share of earnings of a joint venture			
For the year ended December 31, 2018	$ 1,631	$ –	$ 1,631
For the year ended December 31, 2017	1,287	–	1,287
Finance cost			
For the year ended December 31, 2018	$ 6,369	$ 22,209	$ 28,578
For the year ended December 31, 2017 (Restated)	623	22,045	22,668
Finance income			
For the year ended December 31, 2018	$ 47	$ 137	$ 184
For the year ended December 31, 2017	24	140	164
Current income tax charge			
For the year ended December 31, 2018	$ 3,828	$ –	$ 3,828
For the year ended December 31, 2017	1,740	–	1,740

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

(ii) The impairment charge on assets for the year ended December 31, 2018 relates to trade and other receivables (Note 13), 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, 2017 relates to properties for resale (Note 15), inventories (Note 16), prepaid expenses and deposits (Note 17) and property, plant and equipment (Note 18).

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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, 2018	**$ –**	**$ –**	**$ 103,804**	**$ 103,804**
For the year ended December 31, 2017	–	–	120,973	120,973
Non-current assets				
As at December 31, 2018	**$ 161,002**	**$ 140**	**$ 683**	**$ 161,825**
As at December 31, 2017	181,603	467	345	182,415

(i) The revenue information above is based on the locations of the customers.

5. Revenue

Revenue represents the 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, 2018	Year ended December 31, 2017 (Restated)
Depreciation	**$ 33,463**	$ 33,719
Auditors' remuneration	**493**	430
Employee benefit expense (including directors' remuneration)		
Wages and salaries	**$ 9,838**	$ 7,995
Equity-settled share option expense (Note 27)	**79**	123
Pension scheme contributions	**966**	797
	$ 10,883	$ 8,915
Lease payments under operating leases	**$ 925**	$ 864
Foreign exchange loss	**643**	1,116
Impairment/(net reversal of impairment) of property, plant and equipment (Note 18)	**(346)**	11,171
Impairment of coal stockpile inventories (Note 16)	**5,437**	17,026
Provision/(reversal of provision) for doubtful trade and other receivables (Note 13)	**20,892**	(682)
Royalties	**8,237**	–
CIC management fee (Note 31)	**2,697**	3,103
Penalty on late settlement of trade payables (Note 8)	**427**	–
Loss on disposal of properties for resale (Note 15)	**179**	–
Gain on settlement of trade payables (Note 8)	**(2,392)**	–
Gain on disposal of property, plant and equipment (Note 18)	**(994)**	–
Impairment of properties for resale (Note 15)	**2,239**	1,718
Impairment of prepaid expenses and deposits (Note 17)	**134**	380
Provision of commercial arbitration (Note 21)	**124**	2,384
Mining services, net (Note 8)	**–**	2,395
Underprovision of miscellaneous taxes (Note 8)	**–**	1,421
Mine operating costs and other	**31,297**	51,650
Total operating expenses	**$ 114,338**	$ 135,610

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

7. Cost of sales

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

	Year ended December 31, 2018	2017
Operating expenses	**$ 41,068**	$ 55,451
Share-based compensation expense (Note 27)	**4**	30
Depreciation and depletion	**20,466**	20,719
Impairment of coal stockpile inventories (Note 16)	**5,437**	17,026
Cost of sales from mine operations	**66,975**	93,226
Cost of sales related to idled mine assets (i)	**12,860**	12,632
Cost of sales	**$ 79,835**	$ 105,858

(i) Cost of sales related to idled mine assets for the year ended December 31, 2018 includes $12,860 of depreciation expense (2017: includes $12,632 of depreciation expense). 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, 2018 totaled $48,204 (2017: $77,383).

8. Other operating expenses

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

	Year ended December 31, 2018	2017 (Restated)
Reversal of provision/(provision) for doubtful trade and other receivables (Note 13)	**$ (20,892)**	$ 682
Foreign exchange loss	**(643)**	(1,116)
Impairment of prepaid expenses and deposits (Note 17)	**(134)**	(380)
Impairment of properties for resale (Note 15)	**(2,239)**	(1,718)
CIC management fee (Note 31)	**(2,697)**	–
Provision of commercial arbitration (Note 21)	**(124)**	(2,384)
Penalty on late settlement of trade payables	**(427)**	–
Loss on disposal of properties for resale (Note 15)	**(179)**	–
Mining services, net	**–**	(2,395)
Underprovision of miscellaneous taxes	**–**	(1,421)
Gain on settlement of trade payables	**2,392**	–
Gain on disposal of property, plant and equipment (Note 18)	**994**	–
Net reversal of impairment of items of property, plant and equipment (Note 18)	**346**	–
Others	**(4)**	(395)
Other operating expenses	**$ (23,607)**	$ (9,127)

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9. Administration expenses

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

	Year ended December 31, 2018	2017
Corporate administration	**$ 2,639**	$ 2,534
Legal and professional fees	**2,685**	2,464
Salaries and benefits	**5,004**	3,726
Share-based compensation expense (Note 27)	**75**	89
Depreciation	**137**	368
Administration expenses	**$ 10,540**	$ 9,181

10. Finance costs and income

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

	Year ended December 31, 2018	2017 (Restated)
Interest expense on convertible debenture (Note 24)	**$ 22,195**	$ 21,315
Interest expense on borrowings (Note 23)	**2,788**	1,103
Value added tax on interest from intercompany loan	**3,038**	–
Loan arrangement fee (Note 23)	**21**	90
Accretion of decommissioning liability (Note 25)	**536**	160
Finance costs	**$ 28,578**	$ 22,668

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

	Year ended December 31, 2018	2017
Unrealized gain on embedded derivatives in convertible debenture (Note 24)	**$ 137**	$ 137
Interest income	**47**	27
Finance income	**$ 184**	$ 164

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11. Taxes

11.1 Income tax recognized in profit or loss

The Canadian statutory tax rate was 27% (2017: 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, 2018		2017 (Restated)
Loss before tax	$	(37,297)	$	(35,854)
Statutory tax rate		27%		26%
Income tax recovery based on combined Canadian federal and provincial statutory rates		(10,071)		(9,322)
Lower effective tax rate in foreign jurisdictions		4,260		252
Underprovision in prior year		261		–
Tax effect of tax losses and temporary differences not recognized		6,394		7,221
Tax loss utilized		–		(12,164)
Profits or losses attributable to joint venture		408		322
Income not subject to tax		(7,774)		–
Non-deductible expenses		10,350		15,431
Income tax expenses	$	3,828	$	1,740

11.2 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, 2018		2017
Non-capital losses	$	191,307	$	166,274
Capital losses		30,049		30,049
Foreign exchange and others		477,656		392,573
Total unrecognized amounts	$	699,012	$	588,896

11.3 Expiry dates

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

		As at December 31, 2018 U.S. Dollar Equivalent	Expiry dates
Non-capital losses			
Canada	$	184,254	2036 – 2038
Mongolia		4,337	2021
China		2,715	2023
	$	191,306	
Capital losses			
Canada	$	30,049	indefinite

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12. Loss per share

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

	Year ended December 31, 2018	2017 (Restated)
Net loss	**$ (41,125)**	$ (37,594)
Weighted average number of shares	**272,661**	272,188
Basic and diluted loss per share	**$ (0.15)**	$ (0.14)

Potentially dilutive items not included in the calculation of diluted loss per share for the year ended December 31, 2018 include the underlying shares comprised in the convertible debenture (Note 24) and stock options (Note 27) 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, 2018	December 31, 2017 (Restated)	January 1, 2017 (Restated)
Trade receivables	**$ 2,710**	$ 17,549	$ 17,774
Other receivables	**2,336**	3,585	1,660
Total trade and other receivables	**$ 5,046**	$ 21,134	$ 19,434

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, 2018	December 31, 2017 (Restated)	January 1, 2017 (Restated)
Less than 1 month	**$ 4,952**	$ 14,900	$ 5,777
1 to 3 months	**49**	2,302	5,622
3 to 6 months	**45**	3,723	7,937
Over 6 months	**–**	209	98
Total trade and other receivables	**$ 5,046**	$ 21,134	$ 19,434

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.

The new impairment model under IFRS 9 requires the recognition of impairment provisions based on ECL rather than only incurred credit losses as is the case under IAS 39. It applies to financial assets classified at amortized cost. The ECL model requires judgment as to how changes in economic factors affect ECLs, which are determined on a probability-weighted basis. The Company applies the IFRS 9 simplified approach to measuring ECLs on its trade receivables and estimates ECL based on the possible default events on its trade and other receivables over the lifetime of the instruments.

13. Trade and other receivables continued

The Company has determined that the loss allowance on its trade and other receivables was $20,005 (2017: $697 which was not calculated under the ECL model) as at December 31, 2018, based upon an expected loss rate of 10% for trade and other receivables 60 days past due and 100% for trade and other receivables 180 days past due. In addition, a specific provision of certain trade and other receivables of $1,814 was made due to the challenges in collecting the trade and other receivables during the year ended December 31, 2018 (2017: reversal of provision of $682). See note 30 for additional disclosures regarding credit risk.

14. Notes receivables

Notes receivables are financial instruments in the Chinese banking system. As at December 31, 2018, bank notes receivables of $2,500 (2017: $1,898) are readily convertible into cash or can be utilized as settlement of outstanding payables.

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, 2018, the Company recorded an impairment of $2,239 on the unsold units of properties for resale (2017: $1,718). During the current year, certain units of properties for resale with a carrying value of $1,901 were transferred to a supplier of the Company to partially settle payables owing to such supplier in the amount of $1,722, resulting in a loss on settlement of $179.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

16. Inventories

The Company's inventories consist of the following amounts:

	As at December 31, 2018	2017
Coal stockpiles	**$ 31,783**	$ 18,223
Materials and supplies	**15,326**	18,166
Total inventories	**$ 47,109**	$ 36,389

Cost of sales for the year ended December 31, 2018 includes an impairment loss of $5,437 related to the Company's coal stockpile inventories (2017: $17,026). The impairment made for the year ended 2018 is as a result of import restrictions established by Chinese authorities at the Ceke border.

17. Prepaid expenses and deposits

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

	As at		
	December 31, 2018	December 31, 2017 (Restated)	January 1, 2017 (Restated)
Vendor prepayments	**$ 502**	$ 2,153	$ 24
Other prepaid expenses and deposits	**2,793**	2,976	3,373
Total prepaid expenses and deposits	**$ 3,295**	$ 5,129	$ 3,397

For the year ended December 31, 2018, the Company recorded an impairment of $134 on the vendor prepayments (2017 (Restated): $380).

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

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, 2018	$	350,540	$	28,874	$	72,194	$	173,401	$	28,967	$	653,976
Additions		**3,480**		**2,870**		**–**		**36,230**		**2,390**		**44,970**
Disposals		**(41,223)**		**(5,944)**		**–**		**–**		**1,454**		**(45,713)**
Transfers		**–**		**991**		**1,832**		**–**		**(2,823)**		**–**
Exchange realignment		**(31,058)**		**(964)**		**(1,292)**		**(11,905)**		**(371)**		**(45,590)**
As at December 31, 2018	**$**	**281,739**	**$**	**25,827**	**$**	**72,734**	**$**	**197,726**		**29,617**		**607,643**
Accumulated depreciation and impairment charges												
As at January 1, 2018	$	(297,264)	$	(28,326)	$	(51,443)	$	(100,297)	$	(24,189)	$	(501,519)
Depreciation for the year		**(26,507)**		**(384)**		**(4,706)**		**(5,146)**		**–**		**(36,743)**
Eliminated on disposals		**34,390**		**3,319**		**–**		**–**		**–**		**37,709**
Reversal of impairment		**–**		**–**		**–**		**–**		**346**		**346**
Exchange realignment		**23,252**		**1,465**		**3,234**		**3,430**		**84**		**31,465**
As at December 31, 2018	**$**	**(266,129)**	**$**	**(23,926)**	**$**	**(52,915)**	**$**	**(102,013)**	**$**	**(23,759)**	**$**	**(468,742)**
Carrying amount												
As at December 31, 2017	$	53,276	$	548	$	20,751	$	73,104	$	4,778	$	152,457
As at December 31, 2018	**$**	**15,610**	**$**	**1,901**	**$**	**19,819**	**$**	**95,713**	**$**	**5,858**	**$**	**138,901**

		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**

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 $1,210 (2017: $4,169), 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. Depreciation on these assets will commence once they are ready for their intended use.

18.2 Pledge on items of property, plant and equipment

As at December 31, 2018, certain of the Company's property, plant and equipment with a carrying value of $2,643 (2017: $4,539) were pledged as security for a bank loan granted to the Company (Note 23).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

18. Property, plant and equipment continued

18.3 Items of property, plant and equipment held under finance leases

As at December 31, 2018, certain of the Company's mobile equipment of $185 (2017: $672) were held under finance leases.

18.4 Impairment charges

For the year ended December 31, 2018, the Company recorded impairment charges of $213 (2017: $11,171) in respect of the non-depreciable assets. A reversal of impairment of $559 was recorded upon the reuse of certain items of property, plant and equipment previously impaired for the year ended December 31, 2018 (2017: nil).

19. Investment in joint ventures

The Company's investment consists of the following amounts:

	As at December 31, 2018	2017
Non-current investment in joint ventures		
Investment in RDCC LLC	**$ 18,822**	$ 21,052
Investment in Nariin Sukhait Erchim LLC ("NSE")	**9**	–
Total investments	**$ 18,831**	$ 21,052

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, 2018	2017
Balance, beginning of year	**$ 21,052**	$ 21,335
Dividend received	**(2,207)**	(1,991)
Share of earnings of a joint venture	**1,631**	1,287
Share of other comprehensive income/(loss) of a joint venture	**(1,654)**	421
Balance, end of year	**$ 18,822**	$ 21,052

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, 2018	2017
Current assets	**$ 824**	$ 830
Non-current assets	**34,652**	38,610
Total assets	**$ 35,476**	$ 39,440
Current liabilities	**$ 637**	$ 827
Total liabilities	**$ 637**	$ 827

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

19. Investment in joint ventures continued

	Year ended December 31, 2018	2017
Revenue	**$ 7,308**	$ 6,050
Gross profit margin	**4,777**	3,717
Other operating and finance costs	**(295)**	(197)
Profit before tax	**4,482**	3,520
Net profit	**$ 3,892**	$ 3,217
Other comprehensive income	**$ 329**	$ 1,053
Total comprehensive income	**$ 4,221**	$ 4,270

In October 2018, the Company entered into a shareholder agreement with 3 other coal mining companies in respect of NSE, a joint venture entity established for the purpose of constructing power transmission cables and electricity facilities. The Company has a 25% interest in NSE.

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.

The aging of the Company's trade and other payables, based on invoice date, was as follows:

	As at December 31, 2018	2017
Less than 1 month	**$ 34,927**	$ 20,664
1 to 3 months	**16,336**	16,132
3 to 6 months	**5,446**	8,825
Over 6 months	**42,867**	33,598
Total trade and other payables	**$ 99,576**	$ 79,219

21. 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.

On January 10, 2018, the Company received a confidential partial ruling (final except as to costs) with respect to the commercial arbitration. Pursuant to the Arbitration Award, SGS was 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 were reserved for a future award.

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

21. Commercial arbitration continued

On November 14, 2018, the Company executed the Settlement Deed with First Concept in respect of the Arbitration Award. The Settlement Deed provides for the full and final satisfaction of the Arbitration Award as well as the settlement of the issue of costs relating to the Arbitration and any other disputes arising out of the Coal Supply Agreement. Pursuant to the Settlement Deed, which provides for the full and final satisfaction of the Arbitration Award as well as the settlement of the issue of costs relating to the Arbitration and any other disputes arising out of the Coal Supply Agreement, SGS agreed to pay to First Concept the sum of $13,891, together with simple interest thereon at the rate of 6% per annum from November 1, 2018 until full payment, in 12 monthly installments commencing in November 2018. Provided that SGS complies with the terms of the Settlement Deed, First Concept agreed to waive its costs in connection with the Arbitration and interest for the period from January 4, 2018 to October 31, 2018.

As of the date hereof, the Company has not paid the November 2018 and January 2019 monthly payments due under the Settlement Deed. On March 5, 2019, SGS received a notice from First Concept claiming that the Company is default under the Settlement Deed and demanding payment of the full amount of the outstanding monthly payments due under the Settlement Deed by no later than March 11, 2019, otherwise First Concept intends to commence legal action against SGS pursuant to the Settlement Deed. The Company is consulting with its independent litigation counsel regarding this matter; however, as a default is only triggered under the Settlement Deed where there has been a failure to pay two or more consecutive monthly instalment payments, the Company is of the view that SGS is not in default under the Settlement Deed. In the event that First Concept commences legal action against SGS regarding this matter, the Company intends to take appropriate steps to respond to such legal proceedings in the best interests of the Company through independent litigation counsel which has been retained by the Company for this purpose.

As at December 31, 2018, the outstanding amount payable to First Concept amounted to $12,508 (December 31, 2017: $13,884 of provision).

22. Deferred revenue

At December 31, 2018, the Company had deferred revenue of $12,658, which represents cash prepayments from customers for future coal sales (2017 (Restated): $23,225).

23. Interest-bearing borrowings

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

	As at December 31, 2018	2017
Turquoise Hill Loan Facility (i)	**$ 595**	$ 1,708
Equipment loan (ii)	**–**	2,441
Bank loan (iii)	**3,543**	3,041
Finance leases payable (iv)	**113**	503
Total interest-bearing borrowings	**$ 4,251**	$ 7,693

23. 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 London Interbank Offered Rate ("LIBOR") in effect plus 11% per annum; a commitment fee of 35% of the 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 August 29, 2018, the Company and Turquoise Hill entered into a deferral agreement (the "August 2018 Deferral Agreement"), whereby Turquoise Hill agreed to a limited deferral of repayment of all remaining amounts and obligations owing under the TRQ Loan to February 28, 2019 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) $100 per month from August 2018 to September 2018; (ii) $200 per month from October 2018 to January 2019; and (iii) the remaining balance on February 28, 2019 (the payments in (i), (ii) and (iii), the "Repayments"); and
- Interest shall continue to accrue on all outstanding obligations at the 12-month US dollar LIBOR.

Unless otherwise agreed by Turquoise Hill, under certain circumstances, including the non-payment of interest amounts as the same become due, amounts outstanding under the TRQ Loan may be accelerated. Bankruptcy and insolvency events with respect to the Company or its material subsidiaries will result in an automatic acceleration of the indebtedness under the TRQ Loan. Subject to notice and cure periods, certain events of default under the TRQ Loan will result in acceleration of the indebtedness under such loan at the option of Turquoise Hill.

As of the date hereof, the Company has not paid a portion of its February 2018 monthly payment. Pursuant to the terms of the TRQ Loan and the August 2018 Deferral Agreement, the Company is, as of the date hereof, in default of its obligations under the TRQ Loan and the August 2018 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 August 2018 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 August 2018 Deferral Agreement.

As at December 31, 2018, the outstanding principal and accrued interest under this facility amounted to $nil and $732, respectively (December 31, 2017: the outstanding principal and accrued interest under this facility amounted to $1,000 and $708, respectively). A fair value gain of $137 was credited to accumulated deficit upon the adoption of IFRS 9 starting from January 1, 2018.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

23. Interest-bearing borrowings continued

(ii) Equipment Loan

IMSGE executed a loan agreement on August 31, 2017 with subsequent amendments on July 9, 2018 and November 21, 2018 with a third party for the purpose of financing the purchase of mining equipment.

The Company repaid $1,286 to the third party in November 2018 and, as of the date hereof, the Equipment Loan has been fully repaid.

A loan arrangement fee of 1% of the loan principal drawn was charged and amortized throughout the loan term. For the year ended December 31, 2018, $21 of loan arrangement fee was amortized (2017: $8).

(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, SGS 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 matured on May 6, 2018 while the remaining balance of the principal amount of $700 matured 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 were pledged as security (subsequently released upon repayment of loan principal of $2,300).

$2,300 and $700 of the loan principal was repaid to the Bank by the Company in May 2018 and January 2019, respectively, and the loan balance was fully settled.

On May 15, 2018, SGS and the Bank entered into another loan agreement with the key commercial terms as follows:

- Principal amount of the loan (the "2018 Bank Loan") of $2,800;
- Maturity date set at 24 months from drawdown;
- Interest rate of 15% per annum and interest is payable monthly; and
- Certain items of property, plant and equipment were pledged as security for both the Bank Loan and the 2018 Bank Loan. As at December 31, 2018, the net book value of the pledged items of property, plant and equipment was $2,643 (December 31, 2017: $4,539).

As at December 31, 2018, the outstanding principal balance of the Bank Loan, together with the 2018 Bank Loan was $3,500 (December 31, 2017: $3,000) and the Company owed accrued interest of $43 (December 31, 2017: $41).

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

23. 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 1 to 3 years.

At December 31, 2018, the total future minimum lease payments under finance leases and their present values were as follows:

	Minimum lease payments As at December 31,		Present value of minimum lease payments As at December 31,	
	2018	2017	**2018**	2017
Amounts payable:				
Within one year	**$ 90**	$ 192	**$ 83**	$ 162
In the second year	**25**	174	**24**	160
In the third to fifth years, inclusive	**6**	188	**6**	181
Total minimum finance lease payments	**$ 121**	$ 554	**$ 113**	$ 503
Future finance charges	**(8)**	(51)		
Total net lease finance payables	**$ 113**	$ 503		
Portion classified as current liabilities	**(83)**	(162)		
Non-current portion	**$ 30**	$ 341		

24. Convertible debenture

24.1 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, 2018.

24. Convertible debenture continued

24.1 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.
- 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 eight Board of Directors members of which two (Mr. Wen Yao and Ms. Lan Cheng) were 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.
- 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 and options in thousands, unless otherwise indicated)

24. Convertible debenture continued

24.2 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.

24.3 Valuation assumptions

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

	As at December 31,	
	2018	**2017**
Floor conversion price	**CAD$8.88**	CAD$8.88
Ceiling conversion price	**CAD$11.88**	CAD$11.88
Common share price	**CAD$0.14**	CAD$0.18
Historical volatility	**82%**	82%
Risk free rate of return	**2.11%**	2.22%
Foreign exchange spot rate (CAD$ to U.S. Dollar)	**0.73**	0.80
Forward foreign exchange rate curve (CAD$ to U.S. Dollar)	**0.731 – 0.746**	0.795 – 0.802

24.4 Presentation

Based on the Company's valuation as at December 31, 2018, the fair value of the embedded derivatives decreased by $137 compared to December 31, 2017. The decrease was recorded as finance income for the year ended December 31, 2018.

For the year ended December 31, 2018, the Company recorded interest expense of $22,195 related to the convertible debenture as a finance cost (2017: $21,315). 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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24. Convertible debenture continued

24.4 Presentation continued

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

	Year ended December 31, 2018	2017
Balance, beginning of year	**$ 116,374**	$ 117,590
Interest expense on convertible debenture	**22,195**	21,315
Decrease in fair value of embedded derivatives	**(137)**	(137)
Fair value adjustment upon adoption of IFRS 9	**1,469**	–
Interest paid	**–**	(22,394)
Balance, end of year	**$ 139,901**	$ 116,374

The convertible debenture balance consists of the following amounts:

	As at December 31, 2018	2017
Current convertible debenture		
Interest payable	**$ 46,096**	$ 24,242
Debt host	**93,540**	91,730
Fair value of embedded derivatives	**265**	402
Total convertible debenture	**$ 139,901**	$ 116,374

24.5 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, $7,934 and $8,066 of anniversary cash interest to CIC on November 19, 2017, May 19, 2018 and November 19, 2018, respectively. Pursuant to the CIC Convertible Debenture, the Company was also obligated to issue to CIC $4,000 worth of PIK interest shares on November 19, 2017 and $4,000 worth of PIK interest shares on November 19, 2018.

24. Convertible debenture continued

24.5 Interest deferral and settlement continued

As of the date hereof, the Company: (i) has neither paid the Outstanding Cash Interest Payable nor issued the 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. Furthermore, the Common Shares have now been suspended from trading on the HKEX and the Toronto Stock Exchange for a period of more than 5 trading days since December 17, 2018, which represents another event of default under the CIC Convertible Debenture. 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 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 payment of amounts outstanding under the CIC Convertible Debenture and the June 2017 Deferral Agreement.

The Company has been in discussions with CIC for a deferral of the Outstanding Cash Interest Payable and the PIK Interest Shares; however, there can be no assurance that a favorable outcome will be reached.

CIC has notified the Company that, as a condition for agreeing to any deferral, it will require: (i) that the mutual co-operation 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; and (ii) the contractual right to nominate additional nominees for appointment or election to the Board; however, the Company has not entered into any formal agreement to amend the Co-Operation Agreement as of the date hereof.

Under certain conditions, including the non-payment of interest amounts as the same become due or the Common Shares being suspended or halted from trading on any stock exchange for a period of longer than 5 trading days, 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, 2018, IAS 1 requires the Company to classify the entire balance of the CIC Convertible Debenture as a current liability as at December 31, 2018, notwithstanding the fact that CIC has not indicated any intention to deliver notice of default or accelerate the maturity of the CIC Convertible Debenture.

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

25. Decommissioning liability

At December 31, 2018, the decommissioning liability 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 as at December 31, 2018 totaled $8,955 (2017: $8,575). The estimated future reclamation and closure costs are inflated using an estimated inflation rate of 7.1% (2017: 1.8%) and discounted at 11% per annum (2017: 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, 2018 and 2017 were as follows:

	Year ended December 31, 2018	2017
Balance, beginning of year	**$ 5,213**	$ 4,288
Adjustments	**1,544**	765
Accretion	**536**	160
Exchange realignment	**(441)**	–
Balance, end of year	**$ 6,852**	$ 5,213

26. Equity

26.1 Share capital

The Company has authorized an unlimited number of common and preferred shares with no par value. At December 31, 2018, the Company had 272,703 common shares outstanding (2017: 272,607) and no preferred shares outstanding (2017: nil).

26.2 Accumulated deficit and dividends

At December 31, 2018, the Company has accumulated a deficit of $1,181,613 (2017 (Restated): $1,138,179). 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, 2018 (2017: nil).

27. Share-Based Payments

27.1 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, 2018, the Company granted 2,830 stock options (2017: 750) to officers, employees, directors and other eligible persons at an exercise price of CAD$0.13 (2017: exercise prices ranging from CAD$0.33 to CAD$0.39) and expiry dates ranging from July 3, 2023 to August 16, 2023 (2017: expiry dates ranging from June 5, 2022 to June 30, 2022). The weighted average fair value of the options granted in the year ended December 31, 2018 was estimated at $0.04 (CAD$0.05) (2017: $0.08, CAD$0.11) per option at the grant date using the Black-Scholes option pricing model.

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

27. Share-Based Payments continued

27.1 Stock option plan continued

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

	Year ended December 31, 2018	2017
Risk free interest rate	**2.26%**	1.36%
Expected life	**3.4 years**	3 years
Expected volatility (i)	**45%**	45%
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 $85 for the options granted in the year ended December 31, 2018 (2017: $55) will be amortized over the vesting period, of which $25 was recognized in the year ended December 31, 2018 (2017: $28).

The total share-based compensation expense for the year ended December 31, 2018 was $79 (2017: $123). Share-based compensation expense of $75 (2017: $89) has been allocated to administration expenses, share-based compensation expense of $4 (2017: $30) has been allocated to cost of sales and $nil (2017: share-based compensation expense of $4) has been allocated to evaluation and exploration expenses.

27.2 Outstanding stock options

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

	Year ended December 31, 2018			Year ended December 31, 2017		
	Number of options		Weighted average exercise price (CAD$)	Number of options		Weighted average exercise price (CAD$)
Balance, beginning of year	**2,290**	**$**	**0.38**	1,910	$	0.61
Options granted	**2,830**		**0.13**	750		0.34
Options exercised	**–**		**–**	–		–
Options forfeited	**(75)**		**0.13**	(3)		0.92
Options expired	**(350)**		**0.30**	(367)		1.57
Balance, end of year	**4,695**	**$**	**0.23**	2,290	$	0.38

The stock options outstanding and exercisable as at December 31, 2018 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)
$0.13 – $0.29	**3,255**	**$**	**0.15**	**4.20**	**500**	**$**	**0.29**	**1.08**
$0.33 – $0.39	**1,250**		**0.33**	**3.25**	**1,250**		**0.33**	**2.60**
$0.58 – $0.92	**190**		**0.86**	**1.12**	**190**		**0.86**	**1.12**
	4,695	**$**	**0.23**	**3.82**	**1,940**	**$**	**0.38**	**2.06**

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

28. Reserves

28.1 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 27.

The share option reserve transactions for the years ended December 31, 2018 and 2017 are as follows:

	Year ended December 31,	
	2018	2017
Balance, beginning of year	$ **52,463**	$ 52,340
Share-based compensation charged to operations	**79**	123
Balance, end of year	$ **52,542**	$ 52,463

28.2 Capital reserve

Pursuant to the applicable laws and regulations of the People's Republic of China, a portion of the profits of a subsidiary has been transferred to reserve funds (i.e. capital reserve), which the Company is restricted from using.

29. 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 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, 2018, the Company's capital structure consists of convertible debt (Note 24), interest-bearing borrowings (Note 23) and the equity of the Company (Note 26). Except for disclosed elsewhere in the consolidated financial statements, 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, 2018, 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, 2018, the Company had cash of $6,959.

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 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 and options in thousands, unless otherwise indicated)

30. Financial instruments and fair value measurements

30.1 Categories of financial instruments

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

		December 31, 2018		As at December 31, 2017 (Restated)		January 1, 2017 (Restated)
Financial assets						
At amortised cost						
Cash and cash equivalents	**$**	**6,959**		N/A		N/A
Restricted cash		**872**		N/A		N/A
Trade and other receivables (Note 13)		**5,046**		N/A		N/A
Bank notes receivables (Note 14)		**2,500**		N/A		N/A
Loans and receivables						
Cash and cash equivalents		**N/A**	$	6,471	$	966
Trade and other receivables (Note 13)		**N/A**		21,134		19,434
Bank notes receivables (Note 14)		**N/A**		1,898		–
Total financial assets	**$**	**15,377**	$	29,503	$	20,400
Financial liabilities						
Fair value through profit or loss						
Convertible debenture – embedded derivatives (Note 24)	**$**	**265**	$	402	$	540
At amortised cost						
Trade and other payables (Note 20)		**99,576**		79,219		43,628
Provision for commercial arbitration (Note 21)		**12,508**		13,884		–
Interest-bearing borrowings (Note 23)		**4,251**		7,693		8,879
Convertible debenture – debt host (Note 24)		**139,636**		115,972		117,050
Total financial liabilities	**$**	**256,236**	$	217,170	$	170,097

30.2 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, except as disclosed below.

The fair values of the Company's financial instruments classified as FVTPL are determined as follows:

- 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 24) is determined using a Monte Carlo simulation. None of the fair value change in the embedded derivatives for the year ended December 31, 2018 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.

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30. Financial instruments and fair value measurements continued

30.2 Fair value continued

The fair value of all the other financial instruments of the Company, except for the convertible debenture, 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 and disclosed subsequent to initial recognition at fair value, grouped into Level 1 to 3 based on the degree to which the inputs used to determine the fair value are observable.

- Level 1 fair value measurements are those derived from quoted prices in active markets for identical assets or liabilities.
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1, that are observable either directly or indirectly.
- Level 3 fair value measurements are those derived from valuation techniques that include inputs that are not based on observable market data.

	As at December 31, 2018			
Recurring measurements	**Level 1**	**Level 2**	**Level 3**	**Total**
Financial liabilities measured at fair value				
Convertible debenture – embedded derivatives	**$ –**	**$ –**	**$ 265**	**$ 265**
Total financial liabilities measured at fair value	**$ –**	**$ –**	**$ 265**	**$ 265**
Financial liabilities disclosed at fair value				
Convertible debenture – debt host	**–**	**–**	**250,000**	**250,000**
Total financial liabilities disclosed at fair value	**$ –**	**$ –**	**$ 250,000**	**$ 250,000**

	As at December 31, 2017			
Recurring measurements	Level 1	Level 2	Level 3	Total
Financial liabilities measured at fair value				
Convertible debenture – embedded derivatives	$ –	$ –	$ 402	$ 402
Total financial liabilities measured at fair value	$ –	$ –	$ 402	$ 402
Financial liabilities disclosed at fair value				
Convertible debenture – debt host	–	–	250,000	250,000
Total financial liabilities disclosed at fair value	$ –	$ –	$ 250,000	$ 250,000

The fair value of the convertible debenture – debt host as at December 31, 2018 is the face amount of the debt, as that is deemed by the requirements of IFRS 13 – Fair value measurement. However, if that amount were demanded, the Company would be unable to repay the debt in full (see note 1).

There were no transfers between Level 1, 2 and 3 for the year ended December 31, 2018.

30.3 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.

30. Financial instruments and fair value measurements continued

30.3 Financial risk management objectives and policies continued

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 loss before tax 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.

	As at December 31, 2018	2017
Increase/decrease in foreign exchange rate against respective functional currency		
+5%	**$ 567**	$ (2,457)
-5%	**$ (567)**	$ 2,457

Interest rate risk

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

The Company 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 applies the IFRS 9 simplified approach to measuring ECL which uses a lifetime expected loss allowance for all trade and other receivables and notes receivables.

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

30. Financial instruments and fair value measurements continued

30.3 Financial risk management objectives and policies continued

Credit risk continued

To measure the expected credit losses, trade and other receivables and notes receivables have been grouped based on shared credit risk characteristics and the days past due. The expected loss rates are based on the payment profiles of sales over a period of 2 years before December 31, 2018 or January 1, 2018 respectively and the corresponding historical credit losses experienced within this period as well as the forecast regarding the industry environment. On that basis, the loss allowance as at December 31, 2018 and January 1, 2018 (restated on adoption of IFRS 9) was determined as follows for trade and others receivables and notes receivables:

	Less than 1 month	1 to 3 months	3 to 6 months	Over 6 months	Total
As at December 31, 2018					
Expected loss rate	(i)	(i)	10%	100%	
Gross carrying amount – trade and other receivables	$ **5,186**	$ **49**	$ **1,579**	$ **19,847**	$ **26,661**
Gross carrying amount – notes receivables	**2,500**	**–**	**–**	**–**	$ **2,500**
Loss allowance	$ **–**	$ **–**	$ **158**	$ **19,847**	$ **20,005**
As at January 1, 2018 (restated before adoption of IFRS 9)					
Expected loss rate	(i)	(i)	10%	100%	
Gross carrying amount – trade and other receivables	$ 14,900	$ 2,302	$ 3,723	$ 906	$ 21,831
Gross carrying amount – notes receivables	1,898	–	–	–	1,898
Loss allowance	$ –	$ –	$ 372	$ 906	$ 1,278

(i) The expected credit loss rate is considered insignificant.

The closing allowances for trade and other receivables as at December 31, 2018 reconcile to the opening loss allowances as follows:

Loss allowance for trade and other receivables	
As at January 1, 2017, calculated under IAS 39	$ **1,389**
Increase in loan allowance recognised in profit or loss during the year	**707**
Reversal of loan allowance	**(1,389)**
Receivables written off during the year as uncollectible	**(10)**
As at December 31, 2017, calculated under IAS 39	**697**
Amounts restated through opening accumulated losses	**581**
Opening loss allowance as at January 1, 2018 – calculated under IFRS 9	**1,278**
Increase in loan allowance recognised in profit or loss during the year	**19,119**
Reversal of loan allowance	**(41)**
Exchange realignment	**(351)**
Loss allowance as at December 31, 2018	$ **20,005**

The Company's credit risk on cash arises from possible 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 are required to prepay deposits to the Company for future purchasing from the Company, and for those who wish to trade on credit terms are subject to credit verification procedures.

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

30. Financial instruments and fair value measurements continued

30.3 Financial risk management objectives and policies continued

Liquidity risk

Liquidity risk is the risk that the Company will not be able to settle or manage its obligations associated with financial liabilities. Based on the Company's forecasts for the year ending December 31, 2019, the Company is unlikely to have sufficient capital resources and does not expect to generate sufficient cash flows from mining operations in order to satisfy its ongoing obligations and future contractual commitments, including cash interest payments due on the CIC Convertible Debenture. Therefore, the Company is actively seeking additional sources of financing to continue operating and meet its objectives (Note 1).

The Company's current and expected remaining contractual maturities for its financial liabilities with agreed repayment periods are as follows. The table includes the undiscounted cash flows of financial liabilities based on the earliest date on which the Company can be required to satisfy the liabilities.

	0 to 6 months	6 to 12 months	1 to 5 years	Over 5 years	Total
As at December 31, 2018					
Trade and other payables	**$ 99,576**	**$ –**	**$ –**	**$ –**	**$ 99,576**
Provision for commercial arbitration	**7,500**	**4,282**	**–**	**–**	**11,782**
Interest-bearing borrowings (i)	**1,726**	**255**	**3,024**	**–**	**5,005**
Convertible debenture – cash interest (i)	**296,096**	**–**	**–**	**–**	**296,096**
	$ 404,898	**$ 4,537**	**$ 3,024**	**$ –**	**$ 412,459**
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)	274,242	–	–	–	274,242
	$ 357,807	$ 2,763	$ 1,069	$ –	$ 361,639

(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 years ended December 31, 2018 and December 31, 2017. Refer to Note 23 and Note 24 for the terms of the interest-bearing borrowings and convertible debenture, respectively.

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31. 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, 2018	2017
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%**	70%

* SouthGobi Trading (Beijing) Co., Ltd. was registered as a wholly-foreign-owned enterprise under law of China.

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, 2018:

- 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, 2018. 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 December 31, 2018, $2,697 was recorded as a management fee in profit or loss (2017: $3,103).

Furthermore, the Company is in discussions with CIC for a further deferral of the Outstanding Cash Interest Payable and the PIK Interest Shares; 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.

31.1 Related party expenses

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

	Year ended December 31, 2018	2017
Finance costs	**$ 22,196**	$ 21,315
Management fee	**2,697**	3,103
Related party expenses	**$ 24,893**	$ 24,418

31.2 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, 2018	2017
Salaries, fees and other benefits	**$ 1,572**	$ 1,470
Share-based compensation	**66**	58
Total remuneration	**$ 1,638**	$ 1,528

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

32. Supplemental cash flow information

32.1 Non-cash financing and investing activities

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

	Year ended December 31, 2018	2017
Depreciation and amortization capitalized in mineral properties	**$ 8,958**	$ 7,309
Addition to decommissioning liability (Note 26)	**1,454**	765
Trade payables settled by items of property, plant and equipment	**6,943**	–
Trade payables settled by properties for resale	**1,722**	–
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
Convertible debenture interest settlement in shares (Note 25)	**–**	4,000
Purchase of vehicles financed by loans	**–**	222

32.2 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, 2018	2017 (Restated)
Increase in inventories	**$ (13,652)**	$ (15,357)
Increase in trade and other receivables	**(9,564)**	(18,059)
Decrease/(increase) in prepaid expenses and deposits	**741**	(2,334)
Decrease in provision for court case penalty	**–**	(2,890)
Increase in trade and other payables	**34,817**	32,707
Increase/(decrease) in deferred revenue	**(10,308)**	4,324
Reclass of refund customers' deposits as financing activities	**10,565**	–
Increase in restricted cash	**(872)**	–
Net change in non-cash working capital items	**$ 11,727**	$ (1,609)

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33. 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, 2018								
Capital expenditure commitments	**$**	**1,254**	**$**	**–**	**$**	**–**	**$**	**1,254**
Operating expenditure commitments		**9,783**		**970**		**1,798**		**12,551**
Commitments	**$**	**11,037**	**$**	**970**	**$**	**1,798**	**$**	**13,805**
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

Management is currently in discussions with the third party contractor who built the wash plant to negotiate certain terms of the contract.

34. Contingencies

34.1 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.

34. Contingencies continued

34.1 Class Action Lawsuit continued

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. The leave to appeal to the Supreme Court of Canada was dismissed in June 2018.

Counsel for the parties has appeared in a case conference before the motions judge. A procedure to fix the process and timing leading up to the trial of the action has been settled in broad terms including the favourable prospect of an early trial based to a large extent on the existing record. The details of the final process are being negotiated between counsel.

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, 2018 was not required.

34.2 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 coal 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 this $18,500 will be required to be paid. Accordingly, the Company has determined a provision for this matter at December 31, 2018 is not required.

34.3 Notice of Legal Proceedings from a Former Customer

On September 20, 2018, the Company announced that IMSGE had received a court summons (the "Summons") from the Ejinaqi People's Court of Inner Mongolia Autonomous Region of China (the "Ejinaqi Court") in relation to a dispute over certain coal sales contracts with Jiayuguan Xiyuan Trading Co., Ltd ("Xiyuan"), a former customer of IMSGE.

According to the Summons, Xiyuan applied to the Ejinaqi Court claiming that IMSGE should repay a sum of RMB19.4 million (approximately $2,830) to Xiyuan, comprised of RMB19.1 million of coal prepayments and RMB0.3 million of interest. Xiyuan also claimed against Ejinaqi Fulemeng Energy Industry Co., Ltd. ("FLM") for joint liability of the above sums, as it alleged that FLM acted as an agent for IMSGE to receive coal prepayment and deliver coal on behalf of IMSGE.

Subsequently, on January 24, 2019, the Company received noticed that the Ejinaqi Court rendered a judgement allowing an application by Xiyuan to voluntarily withdraw its lawsuit against IMSGE and FLM. Xiyuan's application cited a lack of evidence.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

34. Contingencies continued

34.4 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, 2018, management has assessed that recognition of a provision for uncertain tax position is not necessary.

34.5 Mongolian royalties

During 2017, the Company was ordered by the Mongolian tax authority to apply the "reference price" determined by the Government of Mongolia, as opposed to calculated sales price that is derived based on the actual contract price, in calculating the royalties payable to the Government of Mongolia. Although no official letter has been received by the Company in respect of this matter 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 the royalty will be sustained.

UNAUDITED 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, 2018	2017
Directors' fees	$ 465	$ 330
Other emoluments for executive and non-executive directors		
Salaries and other benefits	473	1,010
Share-based compensation	39	58
Directors' emoluments	$ 977	$ 1,398

Year ended December 31, 2018 Name of director	Directors' fees	Salaries and other benefits	Share-based compensation	Total
Executive directors				
Shougao Wang [(i)]	$ –	$ 290	$ 15	$ 305
	$ –	$ 290	$ 15	$ 305
Non-executive directors				
Zhiwei Chen [(i)]	$ –	$ –	$ –	$ –
Lan Cheng [(i)]	–	–	–	–
Xiaoxiao Li [(i)]	–	–	–	–
Wen (Wayne) Yao	–	–	–	–
Yingbin Ian He	133	–	7	140
Jin Lan Quan	119	–	7	126
Mao Sun	167	–	10	177
Zhu Liu [(ii)]	46	–	–	46
Aminbuhe [(ii)]	–	–	–	–
Yulan Guo [(ii)]	–	183	–	183
	$ 465	$ 183	$ 24	$ 672
Directors' emoluments	$ 465	$ 473	$ 39	$ 977

(i) Appointed to the Board of Directors during the year ended December 31, 2018.

(ii) Resigned from the Board of Directors during the year ended December 31, 2018.

UNAUDITED 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, 2017 Name of director	Directors' fees	Salaries and other benefits	Share-based compensation	Total
Executive director				
Yulan Guo	$ –	$ 390	$ –	$ 390
	$ –	$ 390	$ –	$ 390
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
Ningqiao Li (ii)	–	150	–	150
Huiyi Wang (ii)	–	–	–	–
	$ 330	$ 620	$ 58	$ 1,008
Directors' emoluments	$ 330	$ 1,010	$ 58	$ 1,398

(i) Appointed to the Board of Directors during the year ended December 31, 2017.

(ii) Ceased to be a Director of the Board during the year ended December 31, 2017.

Five highest paid individuals

The five highest paid individuals included one director of the Company for the years ended December 31, 2018 (2017: two directors). The emoluments of the five highest paid individuals are as follows:

	Year ended December 31, 2018	2017
Salaries and other benefits	**$ 1,314**	$ 1,535
Share-based compensation	**35**	–
Total emoluments	**$ 1,349**	$ 1,535

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

	Year ended December 31, 2018	2017
HK$1,000,001 to HK$1,500,000	**–**	–
HK$1,500,001 to HK$2,000,000	**2**	3
HK$2,000,001 to HK$2,500,000	**3**	–
HK$2,500,001 to HK$3,000,000	**–**	–
HK$3,000,001 to HK$3,500,000	**–**	1
HK$3,500,001 to HK$4,000,000	**–**	1
	5	5

UNAUDITED APPENDIX TO THE CONSOLIDATED FINANCIAL STATEMENTS

(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,				
	2018	**2017 (Restated)**	**2016 (Restated)**	**2015**	**2014**
Revenue	**$ 103,804**	$ 120,973	$ 58,450	$ 16,030	$ 24,494
Gross profit/(loss)	**23,969**	15,115	(28,595)	(47,661)	(57,638)
Net comprehensive loss attributable to equity holders of the Company	**$ (54,145)**	$ (37,515)	$ (69,526)	$ (188,040)	$ (104,197)
Basic and diluted loss per share	**$ (0.15)**	$ (0.14)	$ (0.25)	$ (0.79)	$ (0.55)

	As at December 31,				
	2018	**2017 (Restated)**	**2016 (Restated)**	**2015**	**2014**
Total assets	**$ 227,606**	$ 253,436	$ 254,524	$ 290,474	$ 416,139
Less: total liabilities	**(275,746)**	(245,608)	(213,308)	(179,781)	(131,858)
Total equity/(deficiency in assets)	**$ (48,140)**	$ 7,828	$ 41,216	$ 110,693	$ 284,281

A3. Cash

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

	As at December 31,	
	2018	2017
Denominated in U.S. Dollars	**$ 2,207**	$ 5,234
Denominated in Chinese Renminbi	**4,514**	802
Denominated in Mongolian Tugriks	**123**	164
Denominated in Canadian Dollars	**33**	39
Denominated in Hong Kong Dollars	**82**	232
Cash	**$ 6,959**	$ 6,471

CORPORATE INFORMATION

Directors

Executive Director:

Mr. Shougao Wang

Non-Executive Directors:

Mr. Zhiwei Chen
Ms. Lan Cheng
Mr. Xiaoxiao Li
Mr. Wen (Wayne) Yao

Independent Non-Executive Directors:

Mr. Yingbin Ian He
Ms. Jin Lan Quan
Mr. Mao Sun *(interim independent Lead Director)*

Audit Committee

Mr. Mao Sun *(Chair)*
Mr. Yingbin Ian He
Ms. Jin Lan Quan

Nominating and Corporate Governance Committee

Mr. Yingbin Ian He *(Chair)*
Ms. Jin Lan Quan
Mr. Mao Sun

Compensation and Benefits Committee

Ms. Jin Lan Quan *(Chair)*
Mr. Yingbin Ian He
Mr. Mao Sun

Health, Environment, Safety and Social Responsibility Committee

Mr. Shougao Wang *(Chair)*
Mr. Yingbin Ian He
Ms. Lan Cheng
Mr. Aiming Guo

Company Secretaries

Ms. Allison Snetsinger and Mr. Siu Man Kwok

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Principal Place of Business in Hong Kong

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Principal Place of Business in Mongolia

8th Floor, Monnis Building, Orgil Stadium 22, Great Mongolian State Street, 15th Khoroo, Khan-Uul District, Ulaanbaatar, Mongolia, 17011

Principal Place of Business in China

Hanwei International Square Tower 1 5M/F Zone 2, South 4th Ring Xilu 186 Fengtai Beijing, 100160, China

Principal Bankers

Canada:

BMO Bank of Montreal

Hong Kong:

Standard Chartered Bank (Hong Kong) Limited

Principal Share Registrar

AST Trust Company (Canada)
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