SouthGobi Resources Ltd.

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

September 30, 2013

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

FORWARD-LOOKING STATEMENTS

Except for statements of fact relating to the Company, certain information contained herein constitutes forward-looking statements. Forward-looking statements are frequently characterized by words such as "plan", "expect", "project", "intend", "believe", "anticipate" and other similar words, or statements that certain events or conditions "may" or "will" occur. Forward-looking statements are based on the opinions and estimates of management at the dates the statements are made, and are subject to a variety of risks and uncertainties and other factors that could cause actual events or results to differ materially from those projected in the forward-looking statements. These factors include the ability to file the restated financial statements for the affected periods in a timely manner; the full impact of the revised revenue recognition approach on the previously filed financial statements subject to restatement; whether a Management Cease Trade Order will be granted by the Principal Regulator; the conclusions of the Company in respect of any material weaknesses in the Company's controls and procedures; the Company's expectations of sufficient liquidity and capital resources to meets its ongoing obligations and future contractual commitments; the estimates and assumptions included in the Company's impairment analysis; the outcome of the government regulatory and internal investigations; implications of financial statement restatements, or delays in filing thereof with respect to the Company's existing contractual covenants; the outcome of a review of the Dry Coal-Handling Facility to the Company's product strategy; the inherent risks involved in the exploration and development of mineral properties, the uncertainties involved in interpreting drilling results and other geological data, fluctuating commodity prices, the possibility of project cost overruns or unanticipated costs and expenses, uncertainties related to completion results of planned exploration and development programs on the Company's material properties, issuance of licenses and permits and the availability of and costs of financing needed in the future and other factors described in this discussion under the heading "Outlook". Except as required by law, the Company undertakes no obligation to update forward-looking statements if circumstances or management's estimates or opinions should change. The reader is cautioned not to place undue reliance on forward-looking statements.

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

1. INTRODUCTION AND RESTATEMENT

This Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") of SouthGobi Resources Ltd. (which, together with its subsidiaries, is collectively referred to as the "Company" or "SouthGobi") should be read in conjunction with the unaudited condensed consolidated interim financial statements of SouthGobi and the notes thereto for the three and nine month periods ended September 30, 2013 and the three and nine months ended September 30, 2012 (restated). Details of the restatement referred to below are provided in Note 2 to the condensed consolidated interim financial statements for the three and nine month periods ended September 30, 2013. SouthGobi's financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") and Interpretations of the IFRS Interpretations Committee ("IFRIC").

Financial statement restatement

On November 8, 2013, the Company's Board of Directors approved the decision to restate the Company's financial statements for 2011 and 2012, and the related MD&A (collectively, the "Restated Financials"). The restatement follows a review by the Company of its prior revenue recognition practices for its coal sales in the fourth quarter of 2010, full year 2011 and in the first half of 2012.

As a result of this review, the Company determined that certain revenue transactions were previously recognized in the Company's consolidated financial statements prior to meeting relevant revenue recognition criteria. The restatement is due to a change in the determination of when revenue should be recognized from its sales of coal previously recognized in the fourth quarter of 2010, full year 2011 and in the first half of 2012. These transactions relate to coal that had been delivered to the customer's stockpile in a stockyard located within the SouthGobi Ovoot Tolgoi mining license area ("the Stockyard"), the location at which title transferred, but from which the coal had not been collected by the customers. The restatement of the Company's consolidated financial statements reflects a correction in the point of revenue recognition from: (A) the delivery of coal to the customer stockpiles within the Stockyard to (B) the loading of coal onto the customer's trucks at the time of collection.

The Company adopted new terms in its sales contracts starting in the second half of 2012 such that title transfers when coal is loaded onto the customer's trucks which results in the latter point of revenue recognition for all its sales starting from the second half of 2012.

1. INTRODUCTION AND RESTATEMENT (Continued)

As a result of the material effects on the Company's financial statements, the previous financial information provided by the Company in respect of the periods to be covered by the Restated Financials are no longer accurate and should not be relied upon.

The Company is working expeditiously in order to file the full set of audited restated consolidated financial statements and MD&A as at and for the years ended December 31, 2012 and 2011 comprising the Restated Financials. The Restated Financials are expected to be available on or before December 13, 2013.

Notwithstanding the foregoing, if required as a result of a delay in filing the Restated Financials, the Company will be applying to the British Columbia Securities Commission (the "Principal Regulator") pursuant to Part 4 of National Policy 12-203 ("NP 12-203") for a Management Cease Trade Order ("MCTO") in connection with the Restated Financials. If issued, the MCTO will prohibit trading in securities of the Company, whether direct or indirect, by the Company's Chief Executive Officer ("CEO"), Chief Financial Officer ("CFO") and Board of Directors or other persons or companies who had, or may have had, access directly or indirectly to any material fact or material change with respect to the Company that has not been generally disclosed. There can be no assurance that an MCTO will be issued.

If an MCTO is not issued, the Principal Regulator can impose a general cease trade order ceasing all trading in securities of the Company for such period of time as the Principal Regulator may deem appropriate.

While the Company intends to file the Restated Financials as soon as possible, any delay in filing the Restated Financials could ultimately result in an event of default of the Company's convertible debenture held by China Investment Corporation ("CIC"), which if not cured within applicable cure periods in accordance with the terms of such debenture, may result in the principal amount owing and all accrued and unpaid interest becoming immediately due and payable upon notice to the Company by CIC.

1. INTRODUCTION AND RESTATEMENT (Continued)

Financial statement and MD&A presentation

In these consolidated interim financial statements, the Company has restated the financial position at December 31, 2012 and January 1, 2012, the results of operations for the three and nine month periods ended September 30, 2012 and the statement of changes in equity, and statement of cash flows for the nine month period ended September 30, 2012 in the consolidated interim financial statements. Further information on these adjustments and a reconciliation of amounts previously reported is contained in Note 2 of the consolidated interim financial statements. The financial information and other affected information presented in this MD&A, including financial information pertaining to selected quarterly data of 2012 and 2011, have been restated to give effect to the correction in the point of revenue recognition.

Summary of key impacts of restatement

	Six months ended June 30, 2013			Year ended December 31, 2012		
	As previously reported	Adjustment	Restated	As previously reported	Adjustment	Restated
Raw coal production *(millions of tonnes)*	0.19	-	0.19	1.33	-	1.33
Coal sales *(millions of tonnes)*	0.12	0.48	0.60	1.33	0.65	1.98
Average realized selling price *(per tonne)*	$ 34.62	$ (9.92)	$ 24.70	$ 47.76	$ (0.27)	$ 47.49
Revenue	$ 3,633	$ 6,894	$ 10,527	$ 53,116	$ 24,945	$ 78,061
Cost of sales	(34,327)	(4,457)	(38,784)	(97,118)	(30,289)	(127,407)
Other operating expenses	(15,260)	(95)	(15,355)	(54,345)	12,700	(41,645)
Net income/(loss)	(58,564)	1,756	(56,808)	(103,019)	5,517	(97,502)
Basic income/(loss) per share	$ (0.32)	$ 0.01	$ (0.31)	$ (0.57)	$ 0.03	$ (0.54)

	June 30, 2013			December 31, 2012		
	As previously reported	Adjustment	Restated	As previously reported	Adjustment	Restated
Trade and other receivables	$ 7,947	$ (3,764)	$ 4,183	$ 17,430	$ (14,138)	$ 3,292
Inventories	45,872	1,617	47,489	53,661	6,074	59,735
Deferred revenue	-	7,932	7,932	-	8,181	8,181

1. INTRODUCTION AND RESTATEMENT (Continued)

	Year ended December 31, 2011			Year ended December 31, 2010		
	As previously reported	Adjustment	Restated	As previously reported	Adjustment	Restated
Raw coal production *(millions of tonnes)*	4.57	-	4.57	2.79	-	2.79
Coal sales *(millions of tonnes)*	4.02	(0.93)	3.09	2.54	(0.81)	1.73
Average realized selling price *(per tonne)*	$ 54.03	$ (3.39)	$ 50.64	$ 34.61	$ 3.63	$ 38.24
Revenue	$ 179,049	$ (48,293)	$ 130,756	$ 79,777	$ (19,365)	$ 60,412
Cost of sales	(127,343)	35,165	(92,178)	(69,904)	17,253	(52,651)
Other operating expenses	(29,189)	872	(28,317)	(12,643)	218	(12,425)
Net income/(loss)	57,745	(9,192)	48,553	(116,195)	(1,421)	(117,616)
Basic income/(loss) per share	$ 0.32	$ (0.08)	$ 0.24	$ (0.66)	$ (0.01)	$ (0.67)

	December 31, 2011			December 31, 2010		
	As previously reported	Adjustment	Restated	As previously reported	Adjustment	Restated
Trade and other receivables	$ 80,285	$ (64,051)	$ 16,234	$ 30,246	$ (10,911)	$ 19,335
Inventories	52,443	52,418	104,861	26,160	17,253	43,413
Deferred revenue	-	17,653	17,653	-	10,827	10,827

Following the correction in the Company's point of revenue recognition, revenues from affected coal sales contracts are recognized in later periods than previously reported and some revenue remains to be reported in periods after September 30, 2013 as not all contracted coal has been collected by customers. This change results in lower revenues and cost of sales in 2010 and 2011 followed by higher revenues and cost of sales in 2012 and year to date September 30, 2013.

The adjustments to other operating expenses in each applicable period primarily result from the reversal of provisions for doubtful trade and other receivables in those periods.

The impact on the net income/(loss) for the restated periods follows from the restated revenues, net of cost of sales and adjustments to other operating expenses. The net loss for the year 2010 increases, the net income for the year 2011 decreases and the net loss for the year 2012 decreases. The net loss for the six month period ending June 30, 2013 is also lower than previously reported.

During the periods from 2010 to September 30, 2013, trade and other receivables have been adjusted lower and deferred revenue recognized to reflect revenue being recorded in later periods than previously reported. The inventory balance increased over the same period to reflect higher coal inventory stockpile balances. Prepaid expenses also increased, with a corresponding decrease in trade and other payables, as coal sales royalty expenses were recognized in later periods than previously reported.

1. INTRODUCTION AND RESTATEMENT (Continued)

The restatements do not result in a change in cash at the end of any period. The statement of cash flows as reported does not change except for the reclassification of various items within operating activities. Financing activities, investing activities, change in cash, cash at beginning of period and cash at the end of period remain unchanged from previously filed financial statements.

Internal controls over financial reporting

In conjunction with the matter described above, the Company's management has identified a material weakness in the Company's internal controls over financial reporting as of December 31, 2012 and at September 30, 2013, resulting in the failure to properly account for revenues in complex transactions. Specifically, the Company did not ensure that all aspects of sales arrangements were considered in the determination of the appropriate accounting for contracts in which the specified location of transfer of title in the contracts is the customer's stockpile in a stockyard located within the SouthGobi Ovoot Tolgoi mining license area. As a result of the material weakness, the Company's CEO and CFO have concluded that internal controls over financial reporting were not effective as of December 31, 2012 and at September 30, 2013.

Management has been enhancing controls by developing a more thorough review process in evaluating complex sales arrangements in each reporting period. The material weakness cannot be considered remediated until the applicable remedial controls operate for a sufficient period of time and management has concluded, through testing, that these controls are operating. Management expects to remediate this material weakness by December 31, 2013.

2. OVERVIEW

SouthGobi is an integrated coal mining, development and exploration company. SouthGobi's common shares trade on the Toronto Stock Exchange ("TSX") under the symbol SGQ and on the Hong Kong Stock Exchange ("HKEX") under the stock code symbol 1878.

The Company's immediate parent company is Turquoise Hill Resources Ltd. ("Turquoise Hill") and at September 30, 2013, Turquoise Hill owned approximately 57% of the outstanding common shares of the Company. Turquoise Hill is controlled by Rio Tinto plc ("Rio Tinto").

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

The Ovoot Tolgoi Mine, together with the Ovoot Tolgoi Underground Deposit, forms the Ovoot Tolgoi Complex. The Ovoot Tolgoi Complex is separated into two distinct areas, the Sunrise and Sunset Pits.

The Ovoot Tolgoi Mine, strategically located approximately 40km from the Shivee Khuren-Ceke crossing at the Mongolia-China border ("Shivee Khuren Border Crossing"), is the Company's flagship asset. SouthGobi commenced mining at the Ovoot Tolgoi Mine in April 2008 and commenced coal sales in September 2008. Saleable products from the Ovoot Tolgoi Mine will primarily be based on a two product strategy and will consist of SouthGobi standard ("Standard") and SouthGobi premium ("Premium") semi-soft coking coal products. The Standard and Premium semi-soft coking coal products will be produced from raw semi-soft coking coals, together with raw medium and higher-ash coals which can be washed and blended into the Standard and Premium semi-soft coking coal products. Some higher-ash product will be sold as a thermal coal product as required. The Ovoot Tolgoi Mine is covered by a single 9,308 hectare ("ha") mining license and a corresponding permit to mine.

The Soumber Deposit, comprising the Central Soumber, East Soumber, Biluut, South Biluut and Jargalant Fields, is located approximately 20km east of the Ovoot Tolgoi Mine, which will allow any future mining operation at the Soumber Deposit to share existing infrastructure with the Ovoot Tolgoi Mine. A National Instrument 43-101 ("NI 43-101") compliant resource has been established and exploration results indicate potential for thick coking coal seams. The Mineral Resources Authority of Mongolia ("MRAM") has issued the Company a 10,993ha mining license pertaining to the Soumber Deposit.

2. OVERVIEW (Continued)

In addition to the existing mining license, the Company also holds two exploration licenses pertaining to the Soumber Deposit for which pre-mining agreements ("PMAs") have been issued. The Company has applied for a mining license on the area covered by the PMA issued on January 18, 2013. The Company plans to progress to the mining license application process for the PMA issued on August 14, 2013 (refer to Section 3.1 for additional information).

The Zag Suuj Deposit is located approximately 150km east of the Ovoot Tolgoi Mine and approximately 80km north of the Mongolia-China border. A NI 43-101 compliant resource has been established for the Zag Suuj Deposit. Exploration results indicate potential for thick coal seams and it is anticipated that the coals from the Zag Suuj Deposit can be washed to produce a coking coal or coking coal blend product. The Company holds two exploration licenses pertaining to the Zag Suuj Deposit for which PMAs have been issued. The PMAs were issued on August 14, 2013 and the Company plans to progress to the mining license application process (refer to Section 3.1 for additional information).

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

As at September 30, 2013, SouthGobi owned 18.8% of Aspire Mining Limited ("Aspire"), a company listed on the Australian Securities Exchange under the symbol AKM. Aspire's primary focus is its Mongolian coal assets, particularly those pertaining to the Ovoot Coking Coal Project.

2.1 Significant Events

Sales volumes and revenue increased to 0.94 million tonnes and $15.7 million in the third quarter of 2013 compared to 0.32 million tonnes and $6.1 million in the second quarter of 2013. China's economic growth has recently shown signs of gradual improvement with increasing steel production and higher levels of manufacturing activity. Coal prices for both coking and thermal coal stabilized at near four year lows within the third quarter and have moved slightly higher in recent weeks.

The Company produced 1.13 million tonnes of raw coal with a strip ratio of 1.39 in the third quarter of 2013. The Company resumed operations at the Ovoot Tolgoi Mine on March 22, 2013 after having been fully curtailed since the end of the second quarter of 2012. In the second quarter of 2013, the Company primarily moved waste material (overburden) and exposed coal in the pit. Sales volumes increased in the third quarter of 2013 and, as planned, raw coal production increased to meet contracted sales volumes.

2. OVERVIEW (Continued)

On August 22, 2013, the Company announced that it had withdrawn the Notice of Investment Dispute with the Government of Mongolia in recognition of the fact that the dispute was resolved following the grant of three PMAs on August 14, 2013. The PMAs relate to the Zag Suuj Deposit and certain areas associated with the Soumber Deposit.

On September 3, 2013, the Company announced the appointment of Bold Baatar as a non-executive director of the Company.

3. MINERAL PROPERTIES

3.1 Mongolian Coal Division

SouthGobi currently holds three mining licenses and four exploration licenses, which in total cover an area of approximately 325,000ha. The mining licenses pertain to the Ovoot Tolgoi Complex, the Soumber Deposit and the Tsagaan Tolgoi Deposit.

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

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

Regulatory Issues

Governmental, Regulatory and Internal Investigations

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

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

3. MINERAL PROPERTIES (Continued)

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

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

Certain of the allegations raised by the SIA and IAAC against SouthGobi (concerning allegations of bribery, money laundering and tax evasion) have been the subject of public statements and Mongolian media reports, both prior to and in connection with the recent trial, conviction, and unsuccessful appeal of the former Chairman and the former director of the Geology, Mining and Cadastral Department of the MRAM, and others. SouthGobi was not a party to this case. The Company understands that the court process is now concluded following the decision of the Supreme Court of Mongolia to uphold the convictions. As far as the Company is aware from publicly available information, the court concluded that the transfer of one of SouthGobi Sands LLC's licenses (5261X) involved government officials and violated applicable Mongolian anti-corruption laws. License 5261X was transferred to an entity nominated by MRAM, after the license had been reinstated by MRAM for this purpose, in exchange for MRAM renewing certain SouthGobi Sands LLC licenses (5259X, 5277X, 12388X and 9442X) that were due to expire. As a result the court invalidated the transfer of 5261X and cancelled the other licenses. At that time only one of the licenses at issue (9442X) was held by SouthGobi Sands LLC, with the other licenses having earlier been allowed to lapse when they were determined not to be prospective. The Company considers that it was entitled under applicable law to the renewal of the relevant licenses and that it received reasonable payment for the transfer of license 5261X.

3. MINERAL PROPERTIES (Continued)

Through its Audit Committee (comprised solely of independent directors), SouthGobi is conducting an internal investigation into possible breaches of law, internal corporate policies and codes of conduct arising from the allegations which have been raised. The Audit Committee has the assistance of independent legal counsel in connection with its investigation.

The Chair of the Audit Committee is also participating in a tripartite committee, comprised of the Audit Committee Chairs of the Company and Turquoise Hill and a representative of Rio Tinto, which is focused on the investigation of a number of those allegations, including possible violations of anti-corruption laws. Independent legal counsel and forensic accountants have been engaged by this committee to assist it with its investigation. The tripartite committee substantially completed the investigative phase of its activities during the third quarter of 2013. The Company continues to cooperate with the IAAC, SIA and with Canadian and United States government and regulatory authorities that are monitoring the Mongolian investigations. It is possible that these authorities may subsequently conduct their own review or investigation or seek further information from the Company and until all such reviews or investigations are complete the Audit Committee's and the tripartite committee's work may be considered ongoing.

The investigations referred to above could result in one or more Mongolian, Canadian, United States or other governmental or regulatory agencies taking civil or criminal action against the Company, its affiliates or its current or former employees. The likelihood or consequences of such an outcome are unclear at this time but could include financial or other penalties, which could be material, and which could have a material adverse effect on the Company. Refer to the Company's MD&A for the year ended December 31, 2012, which is available at www.sedar.com, Section 13, Risk Factors, "the Company is subject to continuing governmental, regulatory and internal investigations, the outcome of which is unclear at this time but could have a material adverse effect on the Company".

The Company, through its Board of Directors and new management, has taken a number of steps to address issues noted during the investigations and to focus ongoing compliance by employees with all applicable laws, internal corporate policies and codes of conduct, and with the Company's disclosure controls and procedures and internal controls over financial reporting.

3. MINERAL PROPERTIES (Continued)

Withdrawal of Notice of Investment Dispute

On July 11, 2012, SouthGobi announced that SGQ Coal Investment Pte. Ltd., a wholly-owned subsidiary of SouthGobi Resources Ltd. that owns 100% of the Company's Mongolian operating subsidiary SouthGobi Sands LLC, filed a Notice of Investment Dispute on the Government of Mongolia pursuant to the Bilateral Investment Treaty between Singapore and Mongolia. The Company filed the Notice of Investment Dispute following a determination by management that they had exhausted all other possible means to resolve an ongoing investment dispute between SouthGobi Sands LLC and the Mongolian authorities.

The Notice of Investment Dispute principally concerned the failure by MRAM to execute the PMAs associated with certain exploration licenses of the Company pursuant to which valid PMA applications had been lodged in 2011. The areas covered by the valid PMA applications included the Zag Suuj Deposit and certain areas associated with the Soumber Deposit outside the existing mining license.

On August 22, 2013, SouthGobi announced that it had withdrawn the Notice of Investment Dispute in recognition of the fact that the dispute was resolved following the grant of three PMAs on August 14, 2013 relating to the Zag Suuj Deposit and certain areas associated with the Soumber Deposit, and the earlier grant of a PMA on January 18, 2013 pertaining to the Soumber Deposit. Each of the PMAs was granted and executed by MRAM in accordance with Mongolian law.

Mining Prohibition in Specified Areas Law

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

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

3. MINERAL PROPERTIES (Continued)

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

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

The Company understands that the status of the Mining Prohibition in Specified Areas Law is unclear and it has not been enforced to date. Reports from Mongolia suggest that the law may be amended. The Company will continue to monitor developments and will ensure that it is fully compliant with Mongolian law.

Operating Mines

Ovoot Tolgoi Mine

The Ovoot Tolgoi Mine is located in the southwest corner of the Umnugobi Aimag (South Gobi Province) of Mongolia. The deposit is within the administrative unit of Gurvantes Soum, 270km southwest of the provincial capital of Dalanzadgad and 700km southwest of the nation's capital of Ulaanbaatar. To date, mining operations at the Ovoot Tolgoi Mine have been carried out in two distinct areas, the Sunset Pit to the west and the Sunrise Pit to the east.

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

3. MINERAL PROPERTIES (Continued)

Reserves and Resources

On March 19, 2012, the Company announced an updated NI 43-101 compliant independent resource estimate prepared by RungePincockMinarco ("RPM"). RPM estimated that the Ovoot Tolgoi Mine contains 175.7 million tonnes of proven and probable surface coal reserves, 133.3 million tonnes of measured coal resources, 59.9 million tonnes of indicated coal resources and 24.0 million tonnes of inferred coal resources as at October 31, 2011. All of these resources are located above 300m and are amenable to surface mining. The mineral resources are inclusive of mineral reserves. Details of the assumptions and parameters used to calculate the reserves, resources and coal quality estimates and information on data verification are set out in the Annual Information Form dated March 25, 2013, and available at www.sedar.com.

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

3. MINERAL PROPERTIES (Continued)

Select Financial and Operational Data

On March 22, 2013, SouthGobi announced the resumption of operations at the Ovoot Tolgoi Mine after having been fully curtailed since the end of the second quarter of 2012. The 2013 mine plan assumes a conservative resumption of operations, designed to achieve a cost effective approach that will allow operations to continue on a sustainable basis and align production levels with forecast market conditions. The Company is focused on delivering on its commercial strategy and targets.

	Three months ended September 30,		Nine months ended September 30,	
	2013	**2012 (i)**	**2013**	**2012 (i)**
Volumes, Prices and Costs				
Raw coal production *(millions of tonnes)*	**1.13**	-	**1.32**	1.33
Coal sales *(millions of tonnes)*	**0.94**	0.32	**1.54**	1.96
Average realized selling price *(per tonne)* (ii)	**$ 22.05**	$ 16.98	**$ 23.08**	$ 47.48
Direct cash costs of product sold excluding idled mine asset *costs (per tonne)* (iii)	**$ 9.41**	$ 9.56	**$ 9.96**	$ 17.01
Total cash costs of product sold excluding idled mine asset *costs (per tonne)* (iii)	**$ 11.61**	$ 13.31	**$ 13.14**	$ 20.16
Operating Statistics				
Production waste material moved *(millions of bank cubic meters)*	**1.57**	-	**4.68**	3.36
Strip ratio *(bank cubic meters of waste material per tonne of coal produced)*	**1.39**	-	**3.53**	2.52
Operating Results *($ in thousands)*				
Revenue	**$ 15,652**	$ 3,804	**$ 26,179**	$ 76,875
Cost of sales				
Mine operations	**28,975**	12,523	**45,588**	60,661
Idled mine asset costs	**4,511**	18,931	**26,680**	34,517
Gross loss	**$ (17,834)**	$ (27,650)	**$ (46,091)**	$ (18,303)

(i) Restated, see Section 1 of this MD&A and Note 2 to the consolidated interim financial statements for the three and nine months ended September 30, 2013.
(ii) Average realized selling price excludes royalties and selling fees.
(iii) A non-International Financial Reporting Standards ("IFRS") financial measure, see Section 4.

<u>For the three months ended September 30, 2013</u>

For the three months ended September 30, 2013, the Company produced 1.13 million tonnes of raw coal with a strip ratio of 1.39. The Ovoot Tolgoi Mine had been fully curtailed since the end of the second quarter of 2012, therefore there was no production in the third quarter of 2012. In the second quarter of 2013, the Company primarily moved waste material (overburden) and exposed coal in the pit. Sales volumes increased in the third quarter of 2013 and, as planned, raw coal production increased to meet contracted sales volumes. The lower strip ratio in the third quarter of 2013 is primarily the result of the waste material (overburden) activities undertaken in the second quarter of 2013.

3. MINERAL PROPERTIES (Continued)

For the three months ended September 30, 2013, SouthGobi recorded revenue of $15.7 million compared to $3.8 million for the three months ended September 30, 2012. Revenue increased primarily due to increased sales volumes and a higher average realized selling price. The Company sold 0.94 million tonnes of coal at an average realized selling price of $22.05 per tonne in the third quarter of 2013 compared to sales of 0.32 million tonnes of coal at an average realized selling price of $16.98 per tonne in the third quarter of 2012.

Sales in the third quarter of 2013 primarily consisted of Standard semi-soft coking coal mined in 2013, whereas sales in the third quarter of 2012 primarily consisted of thermal coal from the Company's stockpiles to satisfy existing sales contracts.

China's economic growth has recently shown signs of gradual improvement with increasing steel production and higher levels of manufacturing activity. Coal prices for both coking and thermal coal stabilized at near four year lows within the third quarter and have moved slightly higher in recent weeks.

Revenues are presented net of royalties and selling fees. The Company is subject to a 5% royalty on all coal sales exported out of Mongolia based on a set reference price per tonne published monthly by the Government of Mongolia. Effective January 1, 2011, the Company is also subject to a sliding scale additional royalty of up to 5% on coal sales exported out of Mongolia based on the set reference price. However, effective October 1, 2012 (for a six month trial period), the royalty was determined using the contracted sales price per tonne, not the reference price per tonne published by the Government of Mongolia. As a result, the Company's effective royalty rate was reduced significantly over the six month trial period. Despite SouthGobi, together with other Mongolian mining companies, engaging the appropriate Government of Mongolia authorities, the six month trial period was not extended and effective April 1, 2013, the royalty on all coal sales exported out of Mongolia was once again based on a set reference price per tonne published monthly by the Government of Mongolia. Based on the reference prices for the third quarter of 2013, the Company was subject to an average 7% royalty based on a weighted average reference price of $71.17 per tonne. The Company's effective royalty rate for the third quarter of 2013, based on the Company's average realized selling price of $22.05 per tonne, was 23% or $4.99 per tonne compared to $7.53 per tonne for the second quarter of 2013 and $4.83 per tonne for the third quarter of 2012.

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

3. MINERAL PROPERTIES (Continued)

Cost of sales was $33.5 million for the three months ended September 30, 2013 compared to $31.5 million for the three months ended September 30, 2012. Cost of sales comprise the direct cash costs of product sold, mine administration cash costs of product sold, idled mine asset costs, inventory impairments, equipment depreciation, depletion of mineral properties and share-based compensation expense. Of the $33.5 million (2012: $31.5 million) recorded as cost of sales in the third quarter of 2013, $29.0 million (2012: $12.6 million) related to mine operations and $4.5 million (2012: $18.9 million) related to idled mine asset costs. In the third quarter of 2013, cost of sales included a coal stockpile impairment of $10.8 million (2012: $7.2 million) to reduce the carrying value of the Company's coal stockpile to its net realizable value. Cost of sales from mine operations, exclusive of impairments, increased in the third quarter of 2013 compared to the third quarter of 2012 primarily due to higher sales volumes. Cost of sales related to idled mine asset costs primarily consist of period costs, which are expensed as incurred and primarily include depreciation expense. As a result of the recommencement of mining operations at the Ovoot Tolgoi Mine on March 22, 2013, idled mine asset costs decreased in the third quarter of 2013 compared to the third quarter of 2012. However, the 2013 production plan does not fully utilize the Company's existing mining fleet, therefore, idled mine asset costs will continue to be incurred moving forward.

Direct cash costs of product sold excluding idled mine asset costs (a non-IFRS financial measure, see Section 4) were $9.42 per tonne for the three months ended September 30, 2013 compared to $9.56 per tonne for the three months ended September 30, 2012.

Mine administration cash costs of product sold excluding idled mine asset costs (a non-IFRS financial measure, see Section 4) decreased to $2.20 per tonne for the three months ended September 30, 2013 from $3.75 per tonne for the three months ended September 30, 2012 primarily due to mine administration costs being allocated over higher sales volumes.

<u>For the nine months ended September 30, 2013</u>

For the nine months ended September 30, 2013, the Company produced 1.32 million tonnes of raw coal with a strip ratio of 3.53 compared to production of 1.33 million tonnes of raw coal with a strip ratio of 2.52 for the nine months ended September 30, 2012. In the first quarter of 2013, the Company's production was significantly impacted by the curtailment of mining operations until March 22, 2013. In the second quarter of 2013, the Company primarily moved waste material (overburden) and exposed coal in the pit. Sales volumes increased in the third quarter of 2013 and, as planned, raw coal production increased to meet contracted sales volumes.

3. MINERAL PROPERTIES (Continued)

For the nine months ended September 30, 2013, SouthGobi recorded revenue of $26.2 million compared to $76.9 million for the nine months ended September 30, 2012. The Company sold 1.54 million tonnes of coal at an average realized selling price of $23.08 per tonne for the nine months ended September 30, 2013 compared to sales of 1.96 million tonnes of coal at an average realized selling price of $47.48 per tonne for the nine months ended September 30, 2012. Revenue decreased primarily due to decreased sales volumes and a lower average realized selling price.

Revenues are presented net of royalties and selling fees. Based on the reference prices for the nine months ended September 30, 2013, the Company was subject to an average 7% royalty based on a weighted average reference price of $69.16 per tonne. The Company's effective royalty rate for the nine months ended September 30, 2013, based on the Company's average realized selling price of $23.08 per tonne, was 24% or $5.62 per tonne compared to $7.21 per tonne for the nine months ended September 30, 2012.

Cost of sales was $72.3 million for the nine months ended September 30, 2013 compared to $95.2 million for the nine months ended September 30, 2012. Cost of sales comprise the direct cash costs of product sold, mine administration cash costs of product sold, idled mine asset costs, inventory impairments, equipment depreciation, depletion of mineral properties and share-based compensation expense. Of the $72.3 million (2012: $95.2 million) recorded as cost of sales for the nine months ended September 30, 2013, $45.6 million (2012: $60.7 million) related to mine operations and $26.7 million (2012: $34.5 million) related to idled mine asset costs. In the nine months ended September 30, 2013, cost of sales included coal stockpile impairments of $15.8 million (2012: $7.2 million) to reduce the carrying value of the Company's coal stockpile to its net realizable value. Cost of sales related to mine operations, exclusive of impairments, decreased for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012 primarily due to lower sales volumes. Cost of sales related to idled mine asset costs primarily consist of period costs, which are expensed as incurred and primarily include depreciation expense. The depreciation expense relates to the Company's idled plant and equipment.

Direct cash costs of product sold excluding idled mine asset costs (a non-IFRS financial measure, see Section 4) were $9.96 per tonne for the nine months ended September 30, 2013 compared to $17.01 per tonne for the nine months ended September 30, 2012.

Mine administration cash costs of product sold excluding idled mine asset costs (a non-IFRS financial measure, see Section 4) increased to $3.19 per tonne for the nine months ended September 30, 2013 from $3.15 per tonne for the nine months ended September 30, 2012.

3. MINERAL PROPERTIES (Continued)

Processing Infrastructure

On February 13, 2012, the Company announced the successful commissioning of the dry coal handling facility ("DCHF") at the Ovoot Tolgoi Mine. The DCHF has capacity to process nine million tonnes of run-of-mine ("ROM") coal per year. The DCHF includes a 300-tonne-capacity dump hopper, which receives ROM coal from the Ovoot Tolgoi Mine and feeds a coal rotary breaker that sizes coal to a maximum of 50mm and rejects oversize ash. The objective of the DCHF is to reduce screening costs and improve yield recoveries.

The Company has received all permits to operate the DCHF. The 2013 mine plan considered limited utilization of the DCHF at the latter end of 2013, however there is now no plan to use the DCHF in 2013 due to higher quality coals being mined that likely will not require processing through the DCHF. The Company has delayed construction to upgrade the DCHF to include dry air separation modules and covered load out conveyors with fan stackers to take processed coals to stockpiles and enable more efficient blending. Uncommitted capital expenditures have been minimized to preserve the Company's financial resources.

A review of the DCHF, including the upgrade to the DCHF, and its future contribution to the Company's product strategy is ongoing. The total construction capital investment to date is $85.0 million. An impairment loss on the DCHF may be required depending on the outcome of the review.

To further enhance product value, in 2011, the Company entered into an agreement with Ejinaqi Jinda Coal Industry Co. Ltd ("Ejin Jinda"), a subsidiary of China Mongolia Coal Co. Ltd to toll-wash coals from the Ovoot Tolgoi Mine. The agreement has a duration of five years from commencement and provides for an annual wet washing capacity of approximately 3.5 million tonnes of input coal. Pursuant to the terms of the agreement, the Company prepaid $33.6 million of toll washing fees.

3. MINERAL PROPERTIES (Continued)

Ejin Jinda's wet washing facility is located approximately 10km inside China from the Shivee Khuren Border Crossing, approximately 50km from the Ovoot Tolgoi Mine. Primarily, medium and higher-ash coals with only basic processing through Ovoot Tolgoi's on-site DCHF will be transported from the Ovoot Tolgoi Mine to Ejin Jinda's wet washing facility under a separate transportation agreement. Ejin Jinda will charge the Company a single toll washing fee which will cover their expenses, capital recovery and profit.

Based on preliminary studies, the Company expected coals processed through Ovoot Tolgoi's on-site DCHF to then be washed to produce coals with ash in the range of 8% to 11% at a yield of 85% to 90% that generally meet semi-soft coking coal specifications. However, the Company is currently reassessing these preliminary studies and is currently cooperating with Ejin Jinda in studying the utilization of the wet washing facility.

Construction of Ejin Jinda's wet washing facility is now complete and it has been connected to utility supply. As at September 30, 2013, the delay in commencing wet washing coals has had no impact on the carrying value of the Company's prepaid toll washing fees of $33.6 million.

Transportation Infrastructure

On August 2, 2011, the State Property Committee of Mongolia awarded the tender to construct a paved highway from the Ovoot Tolgoi Complex to the Shivee Khuren Border Crossing to consortium partners NTB LLC and SouthGobi Sands LLC (together referred to as "RDCC"). SouthGobi Sands LLC holds a 40% interest in RDCC. On October 26, 2011, RDCC signed a concession agreement with the State Property Committee of Mongolia. RDCC has the right to conclude a 17 year build, operate and transfer agreement under the Mongolian Law on Concessions. Construction on the paved highway re-commenced in the second quarter of 2013 and remains ongoing. During the third quarter of 2013, a sub-contractor employee was fatally injured by a vehicle at the construction site. Following the fatality, additional safety training was carried out by RDCC and its sub-contractors in order to reinforce compliance with safety protocols.

Construction of the paved highway is expected to be substantially complete by the end of 2013. The remaining construction work and commissioning of the paved highway is expected to be completed by the end of the first half of 2014.

The paved highway will have an intended carrying capacity upon completion in excess of 20 million tonnes of coal per year.

3. MINERAL PROPERTIES (Continued)

A north-south railway line currently connects Ceke with Jiayuguan City in Gansu Province and with the interior of China. Another east-west railway line connects Ceke to Linhe, an industrial city in eastern Inner Mongolia. This line has a stated initial transportation capacity of approximately 15 million tonnes per year, with a planned increase to 25 million tonnes per year.

Mining Equipment

The key elements of the currently commissioned mining fleet includes: two Liebherr 996 ($34m^3$) hydraulic excavators, three Liebherr R9250 ($15m^3$) hydraulic excavators, 22 Terex MT4400 (218 tonne capacity) haul trucks and two Terex TR100 (91 tonne capacity) haul trucks, together with various pieces of ancillary equipment.

SouthGobi has secured mining capacity to achieve an annual production level of approximately 7.2 million tonnes in 2014, though the Company's 2013 mine plan does fully utilize its existing mining fleet.

Workforce

As at September 30, 2013, SouthGobi Sands LLC employed 450 employees in Mongolia. Of the 450 employees, 62 are employed in the Ulaanbaatar office, 3 in outlying offices and 376 at the Ovoot Tolgoi Mine site. Of the 450 employees based in Mongolia, 441 (98%) are Mongolian nationals and of those, 214 (48%) are residents of the local Gurvantes, Dalanzadgad, Sevrei and Noyon Soums. SouthGobi Sands LLC's current workforce has been assembled to efficiently support the Company's 2013 mine plan.

Development Projects

Soumber Deposit

The Soumber Deposit, comprising the Central Soumber, East Soumber, Biluut, South Biluut and Jargalant Fields, is located approximately 20km east of the Ovoot Tolgoi Mine. It lies within the administrative units of Gurvantes and Noyon Soums in the Umnugobi Aimag (South Gobi Province), approximately 50km northeast of the Shivee Khuren Border Crossing. The proximity of the Soumber Deposit to the Ovoot Tolgoi Mine will allow any future mining operation at the Soumber Deposit to share existing infrastructure with the Ovoot Tolgoi Mine.

3. MINERAL PROPERTIES (Continued)

The Central and East Soumber Fields include six major seam groups. Approximately 40% of the resources are contained in one seam, averaging 5.9m in thickness. All seam groups consist of a number of coal plies of highly variable thickness, separated by stone partings. Interburden between the seam groups is mainly sandstone and conglomerate, whilst partings within the seam groups tend to be dominated by mudstone and carbonaceous mudstone.

Three major seams have been identified at the Biluut, South Biluut and Jargalant Fields. Correlation of these seams with the Central and East Soumber Fields has not been undertaken. Approximately 60% of the resources are contained in one seam, averaging 5.5m in thickness.

On March 25, 2013, the Company reported an updated NI 43-101 compliant independent resource estimate prepared by RPM. RPM estimated that the Soumber Deposit contains measured coal resources of 62.4 million tonnes, indicated coal resources of 110.3 million tonnes and inferred coal resources of 123.0 million tonnes as at January 10, 2013. Approximately 76% of the Soumber Deposit resource is located above 300m and is amenable to surface mining.

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

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

3. MINERAL PROPERTIES (Continued)

On July 6, 2011, SouthGobi announced that MRAM issued the Company a mining license pertaining to the Soumber Deposit. The 10,993ha mining license was granted for an initial term of 30 years with an option for two 20 year extensions. In addition to the existing mining license, the Company also holds two exploration licenses pertaining to certain areas associated with the Soumber Deposit for which PMAs have been issued. The Company has applied for a mining license on the area covered by the PMA issued on January 18, 2013. The Company plans to progress to the mining license application process for the PMA issued on August 14, 2013 (refer to Section 3.1 for additional information).

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

Zag Suuj Deposit

The Zag Suuj Deposit, located approximately 150km east of the Ovoot Tolgoi Mine and approximately 80km north of the Mongolia-China border, lies within the administrative units of Noyon and Bayandalai Soums in the Umnugobi Aimag (South Gobi Province).

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

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

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

3. MINERAL PROPERTIES (Continued)

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

The coal rank at the Zag Suuj Deposit ranges between low to medium volatile bituminous coal based on the ASTM D388 standard. The average calorific value for individual coal seams ranges between 5,600 and 6,100 kcal/kg (ad).

The Company holds two exploration licenses pertaining to the Zag Suuj Deposit for which PMAs were issued on August 14, 2013 by MRAM. The Company plans to progress to the mining license application process for the PMAs (refer to Section 3.1 for additional information).

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

Ovoot Tolgoi Underground Deposit

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

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

3. MINERAL PROPERTIES (Continued)

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

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

Tsagaan Tolgoi Deposit

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

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

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

Investments

Aspire (18.8% owned)

As at September 30, 2013, SouthGobi owned 18.8% of Aspire, a company listed on the Australian Stock Exchange under the symbol AKM. Aspire's primary focus is its Mongolian coal assets, particularly those pertaining to the Ovoot Coking Coal Project. As at November 14, 2013, SouthGobi had invested a total of $27.9 million in Aspire and its interest in Aspire had a market value of $8.3 million.

On August 28, 2012, Aspire announced that it had received a mining license for the Ovoot Coking Coal Project. On December 6, 2012, Aspire announced that a pre-feasibility study review was completed for the Ovoot Coking Coal Project. Based on information provided by

3. MINERAL PROPERTIES (Continued)

Aspire, coking coal from the Ovoot Coking Coal Project has been classified as a low ash quality blending feedstock for coke manufacture. Indicative washed coking coal average specifications are an ash content of 9%, volatiles of 25-28% and crucible swelling number of 9. Subsequently, on July 31, 2013, Aspire announced an upgraded JORC compliant reserve and resource estimate of 255.0 million tonnes of probable coal reserves, 197.0 million tonnes of measured coal resources, 72.3 million tonnes of indicated coal resources and 11.8 million tonnes of inferred coal resources. Coal resources are inclusive of coal reserves.

Exploration Program

Evaluation and exploration expenses for the three months ended September 30, 2013 were $0.2 million compared to $1.0 million for the three months ended September 30, 2012. Evaluation and exploration expenses will vary period to period depending on the number of projects and the related seasonality of the exploration programs. The Company continues to minimize exploration expenditures to preserve the Company's financial resources.

The Company's 2013 exploration program is focused on further defining the Soumber Deposit. Other exploration activities are limited to ensuring that the Company meets the Mongolian Minerals Law requirements. The Company is also continuing its water exploration program throughout 2013.

3.2 Administrative and Other

For the three months ended September 30, 2013

Refer to section 4 for additional information.

3. MINERAL PROPERTIES (Continued)

For the nine months ended September 30, 2013

Other operating expenses for the nine months ended September 30, 2013 were $16.4 million compared to $22.4 million for the nine months ended September 30, 2012. For the nine months ended September 30, 2013, other operating expenses primarily related to the following:

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

For the nine months ended September 30, 2012, other operating expenses primarily related to a $16.1 million impairment loss related to the Company's investment in Aspire.

Administration expenses for the nine months ended September 30, 2013 were $12.0 million compared to $18.6 million for the nine months ended September 30, 2012. The decrease in administration expenses primarily related to decreased corporate administration, salaries and benefits and share-based compensation expenses, partially offset by increased legal and professional fees due to the ongoing governmental, regulatory and internal investigations (refer to section 3.1 for additional details).

Exploration expenses for the nine months ended September 30, 2013 were $0.7 million compared to $8.1 million for the nine months ended September 30, 2012. Exploration expenses will vary from period to period depending on the number of projects and the related seasonality of the exploration programs. The Company continues to minimize exploration expenditures to preserve the Company's financial resources.

Finance costs for the nine months ended September 30, 2013 were $16.0 million compared to $9.8 million for the nine months ended September 30, 2012. Finance costs for the nine months ended September 30, 2013 primarily consisted of $15.2 million of interest expense on the CIC convertible debenture; whereas, finance costs for the nine months ended September 30, 2012 consisted of $5.7 million interest expense on the CIC convertible debenture and $3.8 million unrealized loss on fair value through profit or loss ("FVTPL") investments.

3. MINERAL PROPERTIES (Continued)

Finance income for the nine months ended September 30, 2013 was $4.3 million compared to $39.2 million for the nine months ended September 30, 2012. For the nine months ended September 30, 2013 and September 30, 2012, finance income primarily consisted of a $4.2 million and $38.9 million unrealized gain on the fair value change of the embedded derivatives in the CIC convertible debenture, respectively. The fair value of the embedded derivatives in the CIC convertible debenture is driven by many factors including: the Company's share price, foreign exchange rates and share price volatility.

For the nine months ended September 30, 2013, the Company recorded a $1 thousand current income tax expense related to its Mongolian operations compared to a current income tax expense of $0.3 million for the nine months ended September 30, 2012. The Company has recorded a deferred income tax expense related to deductible temporary differences and loss carry-forwards of $11.9 million for the nine months ended September 30, 2013 compared to a deferred income tax expense related to deductible temporary differences of $3.2 million for the nine months ended September 30, 2012.

4. SUMMARY OF QUARTERLY RESULTS

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

	2013			2012 (i)				2011 (i)
QUARTER ENDED	**30-Sep**	30-Jun (i)	31-Mar (i)	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec
Revenue	**$ 15,652**	$ 6,129	$ 4,398	$ 1,186	$ 3,804	$ 46,575	$ 26,497	$ 34,626
Gross profit/(loss) excluding idled mine asset costs	**(13,323)**	(5,593)	(494)	(12,601)	(8,719)	20,277	4,657	4,639
Gross profit/(loss) margin excluding idled mine asset costs	***-85%***	*-91%*	*-11%*	*-1063%*	*-229%*	*44%*	*18%*	*13%*
Gross profit/(loss) including idled mine asset costs	**(17,834)**	(11,348)	(16,908)	(31,043)	(27,650)	4,690	4,657	4,639
Other operating expenses	**(1,003)**	(14,925)	(431)	(19,282)	(18,315)	(1,344)	(2,702)	(24,426)
Administration expenses	**(4,204)**	(4,024)	(3,733)	(6,080)	(5,178)	(7,497)	(5,882)	(8,612)
Evaluation and exploration expenses	**(186)**	(221)	(273)	(508)	(958)	(2,099)	(5,033)	(14,513)
Income/(loss) from operations	**(23,227)**	(30,518)	(21,344)	(56,913)	(52,101)	(6,250)	(8,961)	(42,912)
Net income/(loss)	**(41,928)**	(33,140)	(23,666)	(56,564)	(46,413)	15,955	(10,480)	(27,732)
Basic income/(loss) per share	**(0.23)**	(0.18)	(0.13)	(0.31)	(0.26)	0.09	(0.06)	(0.16)
Diluted income/(loss) per share	**(0.23)**	(0.18)	(0.13)	(0.31)	(0.26)	(0.04)	(0.06)	(0.18)

	2013			2012 (i)				2011 (i)
QUARTER ENDED	**30-Sep**	30-Jun (i)	31-Mar (i)	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec
Raw coal production *(millions of tonnes)*	**1.13**	0.17	0.02	-	-	0.27	1.07	1.34
Sales volumes and prices (ii)								
SouthGobi premium semi-soft coking coal								
Coal sales *(millions of tonnes)*	**0.04**	0.21	0.08	0.03	-	0.42	0.33	0.26
Average realized selling price *(per tonne)* (iii)	**$ 37.50**	$ 32.46	$ 45.81	$ 47.86	$ -	$ 67.46	$ 67.58	$ 66.91
SouthGobi standard semi-soft coking coal								
Coal sales *(millions of tonnes)*	**0.87**	-	-	-	0.01	0.36	0.10	0.26
Average realized selling price *(per tonne)* (iii)	**$ 21.67**	$ -	$ -	$ -	$ 49.91	$ 49.74	$ 49.43	$ 48.48
SouthGobi thermal coal								
Coal sales *(millions of tonnes)*	**0.03**	0.11	0.20	-	0.31	0.28	0.15	0.37
Average realized selling price *(per tonne)* (iii)	**$ 13.07**	$ 13.98	$ 13.67	$ -	$ 15.87	$ 34.10	$ 30.29	$ 29.92
Total								
Coal sales *(millions of tonnes)*	**0.94**	0.32	0.28	0.03	0.32	1.06	0.58	0.89
Average realized selling price *(per tonne)* (iii)	**$ 22.05**	$ 26.26	$ 22.75	$ 47.86	$ 16.98	$ 52.86	$ 54.60	$ 46.18
Costs								
Direct cash costs of product sold excluding idled mine asset costs *(per tonne)* (iv)	**$ 9.41**	$ 11.49	$ 10.22	$ 11.67	$ 9.56	$ 16.52	$ 22.09	$ 24.70
Total cash costs of product sold excluding idled mine asset costs *(per tonne)* (iv)	**$ 11.61**	$ 18.63	$ 11.68	$ 16.75	$ 13.31	$ 17.85	$ 28.25	$ 25.92
Waste movement and stripping ratio								
Production waste material moved *(millions of bank cubic meters)*	**1.57**	2.71	0.40	-	-	1.16	2.20	4.58
Strip ratio *(bank cubic meters of waste material per tonne of coal produced)*	**1.39**	15.55	26.21	-	-	4.31	2.07	3.42
Other operating capacity statistics								
Capacity of key mining fleet								
Number of mining shovels/excavators available at period end	**5**	5	5	5	4	4	3	3
Total combined stated mining shovel/excavator capacity at period end *(cubic meters)*	**113**	113	113	113	98	98	64	64
Number of haul trucks available at period end	**24**	24	31	27	27	27	27	25
Total combined stated haul truck capacity at period end *(tonnes)*	**4,978**	4,978	5,615	4,743	4,743	4,743	4,743	4,561
Employees and safety								
Employees at period end	**463**	449	444	465	644	693	720	720
Lost time injury frequency rate (v)	**-**	-	-	0.1	0.2	0.2	0.3	0.2

(i) Restated, see Section 1 of this MD&A and Note 2 to the consolidated interim financial statements for the three and nine months ended September 30, 2013.

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

(iii) Average realized selling price excludes royalties and selling fees.

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

(v) Per 200,000 man hours.

4. SUMMARY OF QUARTERLY RESULTS (Continued)

Summary of key impacts of restatement on quarterly results

	Three months ended June 30, 2013			Three months ended March 31, 2013		
	As previously reported	Adjustment	Restated	As previously reported	Adjustment	Restated
Raw coal production *(millions of tonnes)*	0.17	-	0.17	0.02	-	0.02
Coal sales *(millions of tonnes)*	0.04	0.28	0.32	0.08	0.20	0.28
Average realized selling price *(per tonne)*	$ 14.40	$ 11.86	$ 26.26	$ 45.02	$ (22.27)	$ 22.75
Revenue	$ 374	$ 5,755	$ 6,129	$ 3,259	$ 1,139	$ 4,398
Cost of sales	(12,466)	(5,011)	(17,477)	(21,860)	555	(21,305)
Other operating expenses	(14,877)	(48)	(14,925)	(383)	(48)	(431)
Net income/(loss)	(33,662)	522	(33,140)	(24,901)	1,235	(23,666)
Basic income/(loss) per share	$ (0.18)	$ -	$ (0.18)	$ (0.14)	$ 0.01	$ (0.13)

	Three months ended December 31, 2012			Three months ended September 30, 2012		
	As previously reported	Adjustment	Restated	As previously reported	Adjustment	Restated
Raw coal production *(millions of tonnes)*	-	-	-	-	-	-
Coal sales *(millions of tonnes)*	0.03	-	0.03	0.31	0.01	0.32
Average realized selling price *(per tonne)*	$ 47.86	$ -	$ 47.86	$ 15.79	$ 1.19	$ 16.98
Revenue	$ 1,213	$ (28)	$ 1,185	$ 3,337	$ 467	$ 3,804
Cost of sales	(26,549)	(5,680)	(32,229)	(30,869)	(585)	(31,454)
Other operating expenses	(18,664)	(618)	(19,282)	(29,301)	10,986	(18,315)
Net income/(loss)	(51,818)	(4,746)	(56,564)	(54,564)	8,151	(46,413)
Basic income/(loss) per share	$ (0.28)	$ (0.03)	$ (0.31)	$ (0.30)	$ 0.04	$ (0.26)

	Three months ended June 30, 2012			Three months ended March 31, 2012		
	As previously reported	Adjustment	Restated	As previously reported	Adjustment	Restated
Raw coal production *(millions of tonnes)*	0.27	-	0.27	1.07	-	1.07
Coal sales *(millions of tonnes)*	0.16	0.90	1.06	0.84	(0.26)	0.58
Average realized selling price *(per tonne)*	$ 62.56	$ (9.70)	$ 52.86	$ 56.79	$ (2.19)	$ 54.60
Revenue	$ 8,412	$ 38,163	$ 46,575	$ 40,153	$ (13,656)	$ 26,497
Cost of sales	(22,221)	(19,663)	(41,884)	(17,479)	(4,361)	(21,840)
Other operating expenses	(3,803)	2,459	(1,344)	(2,578)	(124)	(2,702)
Net income/(loss)	237	15,718	15,955	3,126	(13,606)	(10,480)
Basic income/(loss) per share	$ -	$ 0.09	$ 0.09	$ 0.02	$ (0.08)	$ (0.06)

	Three months ended December 31, 2011		
	As previously reported	Adjustment	Restated
Raw coal production *(millions of tonnes)*	1.34	-	1.34
Coal sales *(millions of tonnes)*	1.15	(0.26)	0.89
Average realized selling price *(per tonne)*	$ 55.51	$ (9.33)	$ 46.18
Revenue	$ 51,064	$ (17,438)	$ 33,626
Cost of sales	(34,427)	5,440	(28,987)
Other operating expenses	(24,644)	218	(24,426)
Net income/(loss)	(18,897)	(8,835)	(27,732)
Basic income/(loss) per share	$ (0.10)	$ (0.06)	$ (0.16)

4. SUMMARY OF QUARTERLY RESULTS (Continued)

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

On March 22, 2013, SouthGobi announced the resumption of operations at its Ovoot Tolgoi Mine. The Company recognized revenue of $15.7 million in the third quarter of 2013 compared to $6.1 million in the second quarter of 2013 and $3.8 million in the third quarter of 2012. China's economic growth has recently shown signs of gradual improvement with increasing steel production and higher levels of manufacturing activity. Coal prices for both coking and thermal coal stabilized at near four year lows within the third quarter and have moved slightly higher in recent weeks.

SouthGobi's effective royalty rate in the third quarter of 2013 was 23%. Effective October 1, 2012 (for a six month trial period) the royalty was determined using the contracted sales price per tonne, not the reference price per tonne published by the Government of Mongolia. Despite SouthGobi, together with other Mongolian mining companies, engaging the appropriate Government of Mongolia authorities, the six month trial period was not extended and effective April 1, 2013, the royalty on all coal sales exported out of Mongolia was once again based on a set reference price per tonne published monthly by the Government of Mongolia. Although discussions have not been successful to date, SouthGobi, together with other Mongolian mining companies, continue the dialog with the appropriate Government of Mongolia authorities with the goal of moving to a more equitable process for setting reference prices.

Cost of sales was $33.5 million in the third quarter of 2013 compared to $17.5 million in the second quarter of 2013 and $31.5 million in the third quarter of 2012. Cost of sales comprise the direct cash costs of product sold, mine administration cash costs of product sold, idled mine asset costs, inventory impairments, equipment depreciation, depletion of mineral properties and share-based compensation expense. Of the $33.5 million, $17.5 million and $31.5 million recorded as cost of sales in the third quarter of 2013, the second quarter of 2013 and the third quarter of 2012, $29.0 million, $11.7 million and $12.5 million related to mine operations and $4.5 million, $5.8 million and $18.9 million related to idled mine asset costs, respectively. Cost of sales from mine operations in the third quarter of 2013, the second quarter of 2013 and the third quarter of 2012 included coal stockpile impairments of $10.8 million, $3.9 million and $7.2 million, respectively, to reduce the carrying value of the coal stockpiles to their estimated net realizable values. Cost of sales from mine operations, exclusive of impairments, increased in the third quarter of 2013 compared to the third quarter of 2012 primarily due to higher sales volumes.

4. SUMMARY OF QUARTERLY RESULTS (Continued)

Cost of sales from idled mine asset costs decreased in the third quarter of 2013 compared to the third quarter of 2012 due to the recommencement of mining operations at the Ovoot Tolgoi Mine on March 22, 2013. However, the 2013 production plan does not fully utilize the Company's existing mining fleet, therefore, idled mine asset costs will continue to be incurred moving forward.

The Company recorded a gross loss of $17.8 million in the third quarter of 2013, $11.3 million in the second quarter of 2013 and $27.6 million in the third quarter of 2012. SouthGobi's gross loss in these periods was negatively impacted by idled mine asset costs. The Company recorded a gross loss excluding idled mine asset costs of $13.3 million in the third quarter of 2013, $5.6 million in the second quarter of 2013 and $8.7 million in the third quarter of 2012. Gross profit will vary by quarter depending on sales volumes, sales prices and unit costs.

Other operating expenses in the third quarter of 2013 were $1.0 million compared to $14.9 million in the second quarter of 2013 and $18.3 million in the third quarter of 2012. In the third quarter of 2013, other operating expenses primarily related to a $0.6 million foreign exchange loss. In the second quarter of 2013, other operating expenses primarily related to an impairment loss of $3.1 million related to the Company's investment in Aspire, an impairment loss of $6.9 million related to surplus materials and supplies and $4.3 million of impairment charges to reduce various items of property, plant and equipment to their recoverable amounts. In the third quarter of 2012, other operating expenses primarily related to a $16.1 million an impairment loss related to the Company's investment in Aspire.

Administration expenses in the third quarter of 2013 were $4.2 million compared to $4.0 million in the second quarter of 2013 and $5.2 million in the third quarter of 2012. The increase in administration expenses in the third quarter of 2013 compared to the second quarter of 2013 primarily related to increased legal and professional fees due to the ongoing governmental, regulatory and internal investigations (refer to section 3.1 for additional details) and slightly higher salaries and benefits expenses. The decrease in administration expenses in the third quarter of 2013 compared to the third quarter of 2012 primarily related to decreased salaries and benefits and share-based compensation expenses.

Exploration expenses in the third quarter of 2013 were $0.2 million compared to $0.2 million in the second quarter of 2013 and $1.0 million in the third quarter of 2012. Exploration expenses will vary from quarter to quarter depending on the number of projects and the related seasonality of the exploration programs. The Company continues to minimize exploration expenditures to preserve the Company's financial resources.

4. SUMMARY OF QUARTERLY RESULTS (Continued)

Finance costs in the third quarter of 2013 were $5.4 million compared to $5.2 million in the third quarter of 2012. Finance costs in the third quarter of 2013 primarily consisted of $5.2 million of interest expense on the CIC convertible debenture; whereas, finance costs in the third quarter of 2012 consisted of $3.9 million of interest expense on the CIC convertible debenture and a $1.2 million unrealized loss on FVTPL investments.

Finance income in the third quarter of 2013 was $0.1 million compared to $12.9 million in the third quarter of 2012. In the third quarter of 2013 and 2012, finance income primarily consisted of a $0.1 million and $12.9 million unrealized gain on the fair value change of the embedded derivatives in the CIC convertible debenture, respectively. The fair value of the embedded derivatives in the CIC convertible debenture is driven by many factors including: the Company's share price, foreign exchange rates and share price volatility.

In the third quarter of 2013, the Company recorded $nil current income tax expense related to its Mongolian operations compared to a current income tax recovery of $0.9 million in the third quarter of 2012. The Company has recorded a deferred income tax expense related to deductible temporary differences and loss carry-forwards of $13.4 million in the third quarter of 2013 compared to a deferred income tax expense related to deductible temporary differences of $3.2 million in the third quarter of 2012.

As a result of the above factors, the Company recorded a net loss of $41.9 million in the third quarter of 2013 compared to a net loss of $33.1 million in the second quarter of 2013 and a net loss of $46.4 million in the third quarter of 2012.

Adjusted net loss (a non-IFRS financial measure, see Section 4) was $27.4 million in the third quarter of 2013 compared to an adjusted net loss of $13.5 million in the second quarter of 2013 and an adjusted net loss of $19.4 million in the third quarter of 2012. Adjusted net loss increased in the third quarter of 2013 compared to the second quarter of 2013 and third quarter of 2012 primarily due to higher deferred income tax expenses.

($ in thousands, unless otherwise stated)

	2013			2012 (i)				2011 (i)
QUARTER ENDED	**30-Sep**	30-Jun (i)	31-Mar (i)	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec
Net income/(loss)	**$ (41,928)**	$ (33,140)	$ (23,666)	$ (56,564)	$ (46,413)	$ 15,955	$ (10,480)	$ (27,732)
Income/(loss) adjustments, net of tax								
Idled mine asset costs	**3,383**	4,316	12,312	14,474	13,572	10,966	-	-
Share-based compensation expense/(recovery)	**5**	(21)	154	(1,144)	1,490	4,383	3,799	4,050
Net impairment loss on assets	**10,531**	18,146	581	25,375	23,258	-	-	23,818
Unrealized foreign exchange losses/(gains)	**564**	60	10	906	335	(355)	(794)	(184)
Unrealized loss/(gain) on embedded derivatives in CIC debenture	**(113)**	(3,343)	(748)	(662)	(12,856)	(26,770)	776	(10,790)
Realized loss/(gain) on disposal of FVTPL investments	**39**	43	-	15	-	46	(85)	-
Unrealized loss/(gain) on FVTPL investments	**128**	473	(5)	664	1,197	2,282	339	155
Adjusted net income/(loss) (ii)	**(27,391)**	(13,467)	(11,363)	(16,935)	(19,418)	6,507	(6,446)	(10,683)

(i) Restated, see Section 1 of this MD&A and Note 2 to the consolidated interim financial statements for the three and nine months ended September 30, 2013.
(ii) A non-IFRS financial measure, see Section 5.

5. NON-IFRS FINANCIAL MEASURES

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

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

Cash costs

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

The Company uses this performance measure to monitor its operating cash costs internally and believes this measure provides investors and analysts with useful information about the Company's underlying cash costs of operations. The Company believes that conventional measures of performance prepared in accordance with IFRS do not fully illustrate the ability of its mining operations to generate cash flows. The Company reports cash costs on a sales basis. This performance measure is commonly utilized in the mining industry.

The cash costs of product sold presented below may differ from cash costs of product produced depending on the timing of stockpile inventory turnover.

5. NON-IFRS FINANCIAL MEASURES (Continued)

	Three months ended September 30,		Nine months ended September 30,	
	2013	**2012 (i)**	**2013**	**2012 (i)**
Cash costs				
Cost of sales per financial statements	**$ 33,486**	$ 31,454	**$ 72,268**	$ 95,178
Less non-cash expenses	**(18,049)**	(8,249)	**(25,381)**	(21,189)
Less non-cash idled mine asset costs	**(4,460)**	(13,341)	**(21,332)**	(23,093)
Total cash costs	**10,977**	9,864	**25,555**	50,896
Less idled mine asset cash costs	**(51)**	(5,590)	**(5,347)**	(11,428)
Total cash costs excluding idled mine asset costs	**10,926**	4,274	**20,207**	39,468
Coal sales *(000's of tonnes)*	**941**	321	**1,538**	1,957
Total cash costs of product sold excluding idled mine asset costs *(per tonne)*	**$ 11.61**	$ 13.31	**$ 13.14**	$ 20.16

	Three months ended September 30,		Nine months ended September 30,	
	2013	**2012 (i)**	**2013**	**2012 (i)**
Cash costs				
Direct cash costs of product sold excluding idled mine asset costs *(per tonne)*	**$ 9.41**	$ 9.56	**$ 9.96**	$ 17.01
Mine administration cash costs of product sold excluding idled mine asset costs *(per tonne)*	**2.20**	3.75	**3.19**	3.15
Total cash costs of product sold excluding idled mine asset costs *(per tonne)*	**$ 11.61**	$ 13.31	**$ 13.14**	$ 20.16

(i) Restated, see Section 1 of this MD&A and Note 2 to the consolidated interim financial statements for the three and nine months ended September 30, 2013.

Adjusted net income/(loss)

Adjusted net income/(loss) excludes idled mine asset costs, share-based compensation expense/(recovery), net impairment loss/(recovery) on assets, unrealized foreign exchange losses/(gains), unrealized loss/(gain) on the fair value change of the embedded derivatives in the CIC convertible debenture, realized losses/(gains) on the disposal of FVTPL investments and unrealized losses/(gains) on FVTPL investments. The Company excludes these items from net income/(loss) to provide a measure which allows the Company and investors to evaluate the results of the underlying core operations of the Company and its profitability from operations. The items excluded from the computation of adjusted net income/(loss), which are otherwise included in the determination of net income/(loss) prepared in accordance with IFRS, are items that the Company does not consider to be meaningful in evaluating the Company's past financial performance or the future prospects and may hinder a comparison of its period-to-period results.

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.

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

Factors that could impact the Company's liquidity are monitored regularly and include, but are not limited to, Chinese economic growth, market prices of coal, production levels, operating cash costs, capital costs, exchange rates of currencies of countries where the Company operates and exploration and discretionary expenditures. Factors currently creating uncertainty for the Company's operations include coal prices and the ongoing governmental, regulatory and internal investigations (refer to section 3.1 "governmental, regulatory and internal investigations" for additional information).

While the Company intends to file the Restated Financials for the years ended December 31, 2012 and 2011 as soon as possible (refer to Section 1 Introduction and Restatement), any delay in filing the Restated Financials could ultimately result in an event of default of the Company's convertible debenture held by CIC, which if not cured within applicable cure periods in accordance with the terms of such debenture, may result in the principal amount owing and all accrued and unpaid interest becoming immediately due and payable upon notice to the Company by CIC.

As at September 30, 2013, the Company had cash of $16.1 million compared to cash of $19.7 million and short term money market investments of $15.0 million for a total of $34.7 million in cash and money market investments as at December 31, 2012. Working capital (excess current assets over current liabilities) was $67.8 million as at September 30, 2013 compared to $120.4 million as at December 31, 2012.

6. LIQUIDITY AND CAPITAL RESOURCES (Continued)

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

CIC convertible debenture

In November 2009, the Company entered into a financing agreement with a wholly owned subsidiary of the CIC for $500 million in the form of a secured, convertible debenture bearing interest at 8.0% (6.4% payable semi-annually in cash and 1.6% payable annually in the Company's shares) with a maximum term of 30 years. The CIC convertible debenture is secured by a charge over the Company's assets and certain subsidiaries. The financing was required primarily to support the accelerated investment program in Mongolia and up to $120 million of the financing could also be used for working capital, repayment of debt due on funding, general and administrative expenses and other general corporate purposes. The Company's actual use of financing has been in accordance with the above.

On March 29, 2010, the Company exercised its right to call for the conversion of up to $250.0 million of the CIC convertible debenture into 21.5 million shares at a conversion price of $11.64 (Cdn$11.88). As at September 30, 2013, the CIC owned through its indirect wholly owned subsidiary approximately 15% of the Company.

Foreign Strategic Sectors Law

The terms of the CIC convertible debenture provide for the 1.6% share interest payment of $4.0 million to be paid annually in common shares of the Company. On May 17, 2012, the Parliament of Mongolia approved a Law on Regulation of Foreign Investment in Business Entities Operating in Sectors of Strategic Importance ("Foreign Strategic Sectors Law") that regulated foreign direct investment into a number of key sectors of strategic importance, which includes mineral resources.

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

6. LIQUIDITY AND CAPITAL RESOURCES (Continued)

Following amendments to the Foreign Strategic Sectors Law, passed in the second quarter of 2013, the requirement for parliamentary approval was limited to circumstances where a state owned entity is to exceed 49% share ownership of a strategic asset, irrespective of the amount of investment. As a result, the Company is only required to give notice, rather than obtaining parliamentary or other approval, under the Foreign Strategic Sectors Law for the 1.6% share interest payment to the CIC.

On October 3, 2013 Mongolia's foreign investment environment changed again when the Parliament of Mongolia passed the Investment Law to repeal and replace the Foreign Strategic Sectors Law. The Investment Law regulates, amongst other things, investment by Foreign State Owned Entities ("FSOEs") in sectors of strategic importance, which includes mineral resources, by requiring that FSOEs obtain a permit from Mongolia's Ministry of Economic Development if they are to acquire 33% or more of the shareholding of a Mongolian entity operating in a sector of strategic importance. The Company understands that it will not be required to obtain a permit from the Ministry of Economic Development in connection with the 1.6% share interest payment to CIC, unless such share interest payment will result in CIC acquiring 33% or more of the shareholding in the Company. The Company will fully comply with the requirements of the Investment Law in connection with share interest payments.

Interest payment deferral

During the second quarter of 2013, the Company and the CIC mutually agreed upon a three month deferral of the convertible debenture semi-annual $7.9 million cash interest payment due on May 19, 2013. The Company and the CIC subsequently agreed to an additional deferral of one month, and the cash interest payment became due on September 19, 2013.

On September 19, 2013, the Company settled the $7.9 million amount, plus additional accrued interest of $0.2 million, as follows:

- The Company issued 1.8 million shares to the CIC for the November 19, 2012 1.6% share interest payment, where the number of common shares was based on the 50-day volume-weighted average share price on November 19, 2012 of $2.16Cdn;
- In consideration of the common share issue, the CIC applied the $4.0 million in cash already paid by the Company in the first quarter of 2013 for the November 19, 2012 share interest payment against the amount due on September 19, 2013; and
- The Company paid the remaining $4.1 million balance in cash.

The mutually agreed upon deferral of the cash interest payment, and subsequent settlement in cash and common shares of the Company, did not trigger an event of default and all other terms of the convertible debenture remain unchanged.

6. LIQUIDITY AND CAPITAL RESOURCES (Continued)

Mongolian IAAC investigation

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

The orders placing restrictions on certain of the Company's Mongolian assets could ultimately result in an event of default of the Company's CIC convertible debenture. This matter remains under review by the Company and its advisers but to date, it is the Company's view that this would not result in an event of default as defined under the CIC convertible debenture terms. However, in the event that the orders result in an event of default of the Company's CIC convertible debenture that remains uncured for ten business days, the principal amount owing and all accrued and unpaid interest will become immediately due and payable upon notice to the Company by CIC.

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

<u>Cash Flow Highlights</u>

($ in thousands)

	Nine months ended September 30,	
	2013	**2012**
Cash used in operating activities	**$ (3,275)**	$ (4,122)
Cash generated used in investing activities	**(418)**	(85,965)
Cash generated from/(used in) financing activities	**111**	(122)
Effect of foreign exchange rate changes on cash	**(22)**	186
Decrease in cash for the period	**(3,604)**	(90,023)
Cash balance, beginning of the period	**19,674**	123,567
Cash balance, end of the period	**$ 16,070**	$ 33,544

6. LIQUIDITY AND CAPITAL RESOURCES (Continued)

Cash generated from/(used in) operating activities

Cash used in operating activities for the nine months ended September 30, 2013 was $3.3 million compared to cash used in operating activities for the nine months ended September 30, 2012 of $4.1 million. The cash outflow for the nine months ended September 30, 2013 included a $23.0 million reduction in non-cash working capital items offset by $26.2 million of operating cash outflows before changes in non-cash working capital items.

Cash generated from/(used in) investing activities

Cash used in investing activities was $0.4 million for the nine months ended September 30, 2013 compared to cash used in investing activities of $86.0 million for the nine months ended September 30, 2012. For the nine months ended September 30, 2013, cash used in investing activities primarily related to expenditures on property, plant and equipment and investments in the RDCC LLC joint venture, partially offset by the proceeds from the maturity of short-term investments. For the nine months ended September 30, 2012, cash used in investing activities primarily related to expenditures on property, plant and equipment.

Cash generated from/(used in) financing activities

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

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

6. LIQUIDITY AND CAPITAL RESOURCES (Continued)

Contractual Obligations and Guarantees

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

($ in thousands)	As at September 30, 2013			
	Within 1 year	**2-3 years**	**Over 3 years**	**Total**
Capital expenditure commitments	**$ 15,080**	**$ 12,469**	**$ -**	**$ 27,549**
Operating expenditure commitments (i)	**23,574**	**2,241**	**161**	**$ 25,976**
Commitments	**$ 38,654**	**$ 14,710**	**$ 161**	**$ 53,525**

(i) Operating expenditure commitments include $17.9 million of fees related to the Company's toll wash plant agreement with Ejin Jinda. This amount reflects the minimum expenditure due under this agreement.

Impairment analysis

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

Therefore, the Company conducted an impairment test whereby the carrying value of the Company's Ovoot Tolgoi Mine cash generating unit was compared to its "value-in-use" using a discounted future cash flow valuation model. The Company's Ovoot Tolgoi Mine cash generating unit carrying value was $517.5 million as at September 30, 2013.

6. LIQUIDITY AND CAPITAL RESOURCES (Continued)

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

- Inland Chinese coking coal market coal prices;
- Life-of-mine coal production and operating costs; and
- A discount rate based on an analysis of market, country and company specific factors.

The impairment analysis did not result in the identification of an impairment loss and no charge was required as at September 30, 2013. The Company believes that the estimates and assumptions incorporated in the impairment analysis are reasonable; however, the estimates and assumptions are subject to significant uncertainties and judgments.

Financial instruments

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

The fair values of financial instruments that are traded on an active liquid market are determined with reference to the quoted market prices. The fair value of the Company's investment in the shares of Kangaroo Resources Limited ("Kangaroo"), Aspire and its money market investments are determined using this methodology. The Company's investment in the shares of Kangaroo and its money market investments are classified as FVTPL. The Company's investment in the shares of Aspire is classified as available-for-sale.

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

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

6. LIQUIDITY AND CAPITAL RESOURCES (Continued)

	As at	
Financial assets *($ in thousands)*	**September 30, 2013**	**December 31, 2012 (i)**
Loans-and-receivables		
Cash	**$ 16,070**	$ 19,674
Trade and other receivables	**7,683**	3,292
Available-for-sale		
Investment in Aspire	**6,923**	8,727
Fair value through profit or loss		
Investment in Kangaroo	**331**	1,455
Money market investments	**-**	15,000
Total financial assets	**$ 31,007**	$ 48,148
Financial liabilities *($ in thousands)*		
Fair value through profit or loss		
Convertible debenture - embedded derivatives	**$ 4,672**	$ 8,876
Other-financial-liabilities		
Trade and other payables	**18,938**	10,216
Deferred revenue	**8,395**	8,181
Convertible debenture - debt host	**100,202**	97,092
Total financial liabilities	**$ 132,207**	$ 124,365

(i) Restated, see Section 1 of this MD&A and Note 2 to the consolidated interim financial statements for the three and nine months ended September 30, 2013.

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

	Three months ended September 30,		Nine months ended September 30,	
($ in thousands)	**2013**	**2012**	**2013**	**2012**
Unrealized loss on FVTPL investments	**$ 128**	$ 1,197	**$ 596**	$ 3,818
Unrealized gain on embedded derivatives in CIC debenture	**(113)**	(12,856)	**(4,204)**	(38,851)

Other comprehensive income for the three months ended September 30, 2013 consists of an unrealized gain net of tax on the Company's investment in Aspire of $1.3 million. For the nine months ended September 30, 2013, the Company recognized an impairment loss of $3.1 million in other operating expenses related to its investment in Aspire.

For the three and nine months ended September 30, 2012, the Company recognized an impairment loss of $16.1 million in other operating expenses.

7. ENVIRONMENT

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

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

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

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

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

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

8. RELATED PARTY TRANSACTIONS

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

- Turquoise Hill – Turquoise Hill is the Company's immediate parent company and at September 30, 2013 owned approximately 57% of the outstanding common shares of the Company. Turquoise Hill provides various administrative services to the Company on a cost-recovery basis. The Company also provided some office and investor relations services to Turquoise Hill in the Company's Hong Kong office and recovered the costs for those services on a cost-recovery basis. The Company's provision of office and investor relations services to Turquoise Hill ceased on June 30, 2012.
- Rio Tinto – Rio Tinto is the Company's ultimate parent company and at September 30, 2013 Rio Tinto controlled Turquoise Hill. The Company recovers administration and other costs incurred on behalf of Rio Tinto on a cost-recovery basis. Rio Tinto recovers from the Company the costs of salaries and benefits of employees assigned to work for the Company.
- Global Mining Management ("GMM") – GMM is a private company owned equally by seven companies, two of which include the Company and Turquoise Hill. GMM provides administration, accounting and other office services to the Company on a cost-recovery basis.
- Turquoise Hill Resources Singapore Pte. Ltd. ("Turquoise Hill Singapore") – Turquoise Hill Singapore (formerly I2MS.NET Pte. Ltd.) is a private company 100% owned by Turquoise Hill. Turquoise Hill Singapore provides information technology and other related services to the Company on a cost-recovery basis.
- Ivanhoe Energy Inc. ("Ivanhoe Energy") – Ivanhoe Energy is a publicly listed company and in 2012 had two directors in common with the Company. The Company provided some office and investor relations services to Ivanhoe Energy in the Company's Hong Kong office and recovered the costs for those services on a cost-recovery basis. The Company's provision of office and investor relations services to Ivanhoe Energy ceased on June 30, 2012.

8. RELATED PARTY TRANSACTIONS (Continued)

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

($ in thousands)	Three months ended September 30, 2013	Three months ended September 30, 2012	Nine months ended September 30, 2013	Nine months ended September 30, 2012
Corporate administration	**$ 214**	$ 260	**$ 595**	$ 1,107
Salaries and benefits	**685**	186	**1,167**	757
Total related party expenses	**$ 899**	$ 446	**$ 1,762**	$ 1,864

($ in thousands)	Three months ended September 30, 2013	Three months ended September 30, 2012	Nine months ended September 30, 2013	Nine months ended September 30, 2012
GMM	**$ 2**	$ 213	**$ 59**	$ 950
Turquoise Hill	**93**	-	**192**	7
Rio Tinto	**611**	-	**1,001**	-
Turquoise Hill Singapore	**193**	233	**510**	907
Total related party expenses	**$ 899**	$ 446	**$ 1,762**	$ 1,864

The Company recorded recoveries of $7.0 thousand and $14.0 thousand for the three and nine months ended September 30, 2013 for administration expenses with Rio Tinto compared to recoveries of $0.2 million and $0.7 million for the three and nine months ended September 30, 2012 for administration expenses with Turquoise Hill and Ivanhoe Energy.

The Company had accounts receivable of $0.1 million as at September 30, 2013 (December 31, 2012: $0.7 million) and accounts payable of $1.1 million as at September 30, 2013 (December 31, 2012: $35.0 thousand) with related parties.

Emolument Policy

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

8. RELATED PARTY TRANSACTIONS (Continued)

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

The Company has also adopted an equity incentive plan to incentivize directors and eligible employees. Details of the plan are set out in Note 18 of the Consolidated Interim Financial Statements.

As at September 30, 2013, the Company employed 463 employees.

9. 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 November 14, 2013, 183.3 million common shares were issued and outstanding. There are also incentive share options outstanding to acquire 2.8 million unissued common shares with exercise prices ranging from Cdn$1.16 to Cdn$14.25. There are no preferred shares outstanding.

As at November 14, 2013, Turquoise Hill directly owned 104.8 million common shares representing approximately 57% of the issued and outstanding common shares of the Company.

10. INTERNAL CONTROLS OVER FINANCIAL REPORTING

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

In conjunction with the financial statement restatement described in Section 1 of this MD&A, the Company's management has identified a material weakness in the Company's internal controls over financial reporting as of December 31, 2012 and as of September 30, 2013, resulting in the failure to properly account for revenues in complex transactions. Specifically, the Company did not ensure that all aspects of sales arrangements were considered in the determination of the appropriate accounting for contracts in which the specified location of transfer of title in the contracts is the customer's stockpile in a stockyard located within the SouthGobi Ovoot Tolgoi mining license area. As a result of the material weakness, the Company's Chief Executive Officer and Chief Financial Officer have concluded that internal controls over financial reporting were not effective as of December 31, 2012 and as of September 30, 2013.

10. INTERNAL CONTROLS OVER FINANCIAL REPORTING (Continued)

Management has been enhancing controls by developing a more thorough review process in evaluating complex sales arrangements in each reporting period. The material weakness cannot be considered remediated until the applicable remedial controls operate for a sufficient period of time and management has concluded, through testing, that these controls are operating. Management expects to remediate this material weakness by December 31, 2013.

11. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

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

Please refer to Note 3.3 of the Company's September 30, 2013 consolidated interim financial statements for information regarding the accounting judgments and estimates that have the most significant effect on the amounts recognized in the Company's consolidated interim financial statements.

12. ACCOUNTING PRONOUNCEMENTS

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

12. ACCOUNTING PRONOUNCEMENTS (Continued)

IFRS 10 Consolidated Financial Statements

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

IFRS 11 Joint Arrangements

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

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

IFRS 12 Disclosure of Interests in Other Entities

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

IFRS 13 Fair Value Measurement

IFRS 13 provides a definition of fair value, sets out a single IFRS framework for measuring fair value and outlines disclosure requirements for fair value measurements. The adoption of IFRS 13 has resulted in additional fair value measurement disclosures in the Company's Consolidated Interim Financial Statements (refer to Note 19) and will result in incremental disclosures in the Company's Annual Consolidated Financial Statements.

12. ACCOUNTING PRONOUNCEMENTS (Continued)

IAS 1 Presentation of Financial Statements (Amendment)

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

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

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

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

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

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

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

12. ACCOUNTING PRONOUNCEMENTS (Continued)

Other

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

The IASB has suspended the originally planned effective date of January 1, 2015 for IFRS 9 "Financial Instruments". The IASB issued IFRS 9 as the first step in its project to replace IAS 39 "Financial Instruments: Recognition and Measurement". The Company will commence assessing the impact of this new standard upon the announcement of its new effective date.

13. RISK FACTORS

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

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

Refer to the Company's MD&A for the year ended December 31, 2012, Section 13, Risk Factors, "If an event of default occurs under the convertible debenture, CIC has the right to accelerate amounts owing thereunder." This risk factor is replaced with the following:

"If an event of default occurs under the convertible debenture, CIC has the right to accelerate amounts owing thereunder

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

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

13. RISK FACTORS (Continued)

Refer to the Company's MD&A for the year ended December 31, 2012, Section 13, Risk Factors, "The Application of the Foreign Investment Law approved by the Parliament of Mongolia is uncertain." The Company considers that this risk factor has been substantially mitigated following the repeal of the Foreign Investment Law and introduction of the Investment Law on October 3, 2013, which appears to provide greater certainty for foreign investment in Mongolia. However, the Company remains subject to the risk factor described in the Company's MD&A for the year ended December 31, 2012, Section 13, Risk Factors, "The Company's ability to carry on business in Mongolia is subject to political risk".

14. OUTLOOK

China's economic growth has recently shown signs of gradual improvement with increasing steel production and higher levels of manufacturing activity. Coal prices for both coking and thermal coal stabilized at near four year lows within the third quarter and have moved slightly higher in recent weeks. Mongolian coal exports to China increased by 6.1% during the third quarter compared to the second quarter with 11.1 million tonnes of coal exported in the year to date. Current market sentiment still remains uncertain and prices are not expected to rise dramatically for the remainder of the year and in to the first quarter of 2014. The longer term outlook is more positive, but remains dependent on the Chinese economy.

The Company resumed operations at the Ovoot Tolgoi Mine on March 22, 2013 after having been fully curtailed since the end of the second quarter of 2012. In the second quarter of 2013, the Company primarily moved waste material (overburden) and exposed coal in the pit. Sales volumes increased in the third quarter of 2013 and, as planned, raw coal production increased to meet contracted sales volumes. The rate of production in the fourth quarter of 2013 is expected to increase compared to the third quarter of 2013 as the Company provides contractual tonnages under current coal supply agreements and makes further sales. The Company expects total coal sales in excess of 1.50 million tonnes in the fourth quarter of 2013 subject to customer performance under the current coal supply agreements. As a result, the Company expects 2013 annual raw coal production of approximately 3.0 million tonnes.

Whilst SouthGobi has a predominantly two product strategy of a Premium and Standard semi-soft coking coal product from the Ovoot Tolgoi Mine, the capability to begin supplying a washed semi-soft coking coal product is an important step in improving both SouthGobi's market position and access to end customers. The Company is currently cooperating with Ejin Jinda in studying the utilization of the wet washing facility. SouthGobi has, however, commenced mining and selling some Premium semi-soft coking coal product as a raw coal in 2013.

14. OUTLOOK (Continued)

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

Longer term, SouthGobi remains well positioned, with a number of key competitive strengths, including:

- Strategic location – SouthGobi is the closest major coking coal producer in the world to China. The Ovoot Tolgoi Mine is approximately 40km from China, which is approximately 190km closer than Tavan Tolgoi coal producers in Mongolia and 7,000 to 10,000km closer than Australian and North American coking coal producers. The Company has an infrastructure advantage, being approximately 50km from existing railway infrastructure, which is approximately one tenth the distance to rail of Tavan Tolgoi coal producers in Mongolia.
- Premium quality coals – Most of the Company's coal resources have coking properties, including a mixture of semi-soft coking coals and hard coking coals.
- Favorable cost structure – The long-term cost structure of SouthGobi provides a strong base for sustainable growth when access to end-user markets is obtained.
- Substantial resource base – The Company's aggregate coal resources (including reserves) include measured and indicated resources of 533 million tonnes and inferred resources of 302 million tonnes.

14. OUTLOOK (Continued)

Objectives

The Company's objectives for 2013 are as follows:

- Resume production at the Ovoot Tolgoi Mine – The Company reviewed the overall structure of its workforce and market conditions and recommenced mining activities at the Ovoot Tolgoi Mine in March 2013. The focus has been to recommence mining activities in a safe manner that provides a sustainable long-term operating base.
- Continue to develop regional infrastructure – The Company's priority was to complete the construction of the paved highway from the Ovoot Tolgoi Mine to the Shivee Khuren Border Crossing as part of the existing consortium that was awarded the tender by the end of 2013. Construction of the paved highway is expected to be substantially complete by the end of 2013. The remaining construction work and commissioning of the paved highway is expected to be completed by the end of the first half of 2014.
- Advance the Soumber Deposit – The Company intends to substantially advance the feasibility, planning and physical preparation of the Soumber Deposit in order to commence small-scale mining activities in 2014.
- Value-adding/upgrading coal – Implement an effective and profitable utilization of the wet washing facility contracted with Ejin Jinda to toll-wash coal from the Ovoot Tolgoi Mine and further develop the Company's marketing plans on product mix and seek to expand the Company's customer base. The Company is currently cooperating with Ejin Jinda in studying the utilization of the wet washing facility.
- Re-establish the Company's reputation – The Company's vision is to be a respected and profitable Mongolian coal company. This will require re-establishing good working relationships with all our external stakeholders.
- Operations – Continuing to focus on production safety, environmental protection, operational excellence and community relations.

November 14, 2013