



**SouthGobi
Resources**

**SouthGobi Resources Ltd.
Condensed Consolidated Interim Financial Statements**

June 30, 2014
(Expressed in U.S. Dollars)
(Unaudited)

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SouthGobi Resources Ltd.

Condensed Consolidated Interim Statements of Comprehensive Income

(Unaudited)

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

	Notes	Three months ended June 30,		Six months ended June 30,	
		2014	2013	2014	2013
			(Restated - Note 2)		(Restated - Note 2)
Revenue		\$ 6,691	\$ 6,129	\$ 11,828	\$ 10,527
Cost of sales	5	(20,086)	(17,477)	(38,452)	(38,783)
Gross loss		(13,395)	(11,348)	(26,624)	(28,256)
Other operating expenses	6	(1,776)	(14,925)	(2,849)	(15,355)
Administration expenses	7	(2,253)	(4,024)	(4,490)	(7,757)
Evaluation and exploration expenses	8	(107)	(221)	(279)	(494)
Loss from operations		(17,531)	(30,518)	(34,242)	(51,862)
Finance costs	9	(5,215)	(5,617)	(10,240)	(10,608)
Finance income	9	127	3,366	1,134	4,136
Share of earnings/(losses) of joint venture	13	(3)	44	(29)	27
Loss before tax		(22,622)	(32,725)	(43,377)	(58,307)
Current income tax expense		(546)	-	(546)	(1)
Deferred income tax recovery/(expense)		-	(416)	-	1,501
Net loss attributable to equity holders of the Company		(23,168)	(33,141)	(43,923)	(56,807)
Other comprehensive income/(loss) to be reclassified to profit or loss in subsequent periods					
Change in value of available-for-sale financial asset, net of tax		414	(930)	(100)	-
Net comprehensive loss attributable to equity holders of the Company		\$ (22,754)	\$ (34,071)	\$ (44,023)	\$ (56,807)
Basic loss per share	10	\$ (0.12)	\$ (0.18)	\$ (0.23)	\$ (0.31)
Diluted loss per share	10	\$ (0.12)	\$ (0.18)	\$ (0.23)	\$ (0.31)

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

SouthGobi Resources Ltd.

Condensed Consolidated Interim Statements of Financial Position

(Unaudited)

(Expressed in thousands of U.S. Dollars)

	Notes	As at	
		June 30, 2014	December 31, 2013
Assets			
Current assets			
Cash		\$ 8,789	\$ 21,837
Trade and other receivables	11	896	2,578
Inventories	12	42,259	40,288
Prepaid expenses and deposits		5,666	11,506
Total current assets		57,610	76,209
Non-current assets			
Property, plant and equipment	14	381,704	399,395
Long term investments	13	28,918	30,602
Total non-current assets		410,622	429,997
Total assets		\$ 468,232	\$ 506,206
Equity and liabilities			
Current liabilities			
Trade and other payables	15	\$ 18,830	\$ 31,241
Deferred revenue		13,992	997
Interest-bearing borrowings	17	3,800	-
Current portion of convertible debenture	16	4,285	2,301
Total current liabilities		40,907	34,539
Non-current liabilities			
Convertible debenture	16	93,249	94,302
Decommissioning liability		2,653	2,308
Total non-current liabilities		95,902	96,610
Total liabilities		136,809	131,149
Equity			
Common shares		1,067,846	1,067,839
Share option reserve		51,580	51,198
Investment revaluation reserve		414	514
Accumulated deficit	18	(788,417)	(744,494)
Total equity		331,423	375,057
Total equity and liabilities		\$ 468,232	\$ 506,206
Net current assets		\$ 16,703	\$ 41,670
Total assets less current liabilities		\$ 427,325	\$ 471,667

Corporate information and going concern (Note 1), commitments for expenditure (Note 23) and contingencies (Note 24)

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

APPROVED BY THE BOARD:

"Andre Deepwell"
Director

"Pierre Lebel"
Director

SouthGobi Resources Ltd.

Condensed Consolidated Interim Statements of Changes in Equity

(Unaudited)

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

	Number of shares	Common shares	Share option reserve	Investment revaluation reserve	Accumulated deficit	Total
Balances, January 1, 2013	181,928	\$ 1,059,710	\$ 51,303	\$ -	\$ (507,030)	\$ 603,983
Shares issued for:						
Employee share purchase plan	38	81	-	-	-	81
Share-based compensation charged to operations	-	-	133	-	-	133
Net loss for the period	-	-	-	-	(56,807)	(56,807)
Balances, June 30, 2013 (Restated - Note 2)	181,966	\$ 1,059,791	\$ 51,436	\$ -	\$ (563,837)	\$ 547,390
Balances, January 1, 2014	187,309	\$ 1,067,839	\$ 51,198	\$ 514	\$ (744,494)	\$ 375,057
Shares issued for:						
Employee share purchase plan	8	7	-	-	-	7
Share-based compensation charged to operations	-	-	382	-	-	382
Net loss for the period	-	-	-	-	(43,923)	(43,923)
Change in value of available-for-sale financial asset, net of tax	-	-	-	(100)	-	(100)
Balances, June 30, 2014	187,317	\$ 1,067,846	\$ 51,580	\$ 414	\$ (788,417)	\$ 331,423

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

SouthGobi Resources Ltd.

Condensed Consolidated Interim Statements of Cash Flows

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

	Notes	Six months ended June 30,	
		2014	2013
Operating activities			(Restated - Note 2)
Loss before tax		\$ (43,377)	\$ (58,307)
Adjustments for:			
Depreciation and depletion		14,149	17,164
Share-based compensation	19	381	133
Finance costs	9	10,240	10,608
Finance income	9	(1,134)	(4,136)
Share of losses/(earnings) of joint venture	13	29	(27)
Interest paid		(7,958)	(4,011)
Commitment fee and front end fee		(133)	-
Income tax paid		(5)	-
Unrealized foreign exchange gain		(405)	(26)
Loss on disposal of property, plant and equipment		-	623
Impairment loss on available-for-sale financial asset	13	1,766	3,067
Impairment of inventories	12	13,527	13,065
Impairment of property, plant and equipment		277	4,299
Net proceeds from disposal of mining license		(1,273)	-
Other adjustments		-	16
Operating cash flows before changes in non-cash working capital items		(13,916)	(17,532)
Net change in non-cash working capital items	22	(140)	10,339
Cash used in operating activities		(14,056)	(7,193)
Investing activities			
Expenditures on property, plant and equipment		(4,059)	(7,979)
Proceeds from disposal of property, plant and equipment		-	717
Interest received		5	74
Proceeds from maturity or disposal of short and long term investments		74	15,226
Net proceeds from disposal of mining license		1,273	-
Investment in joint venture		-	(1,579)
Cash generated from/(used in) investing activities		(2,707)	6,459
Financing activities			
Proceeds from issuance of common shares		7	81
Drawings under borrowing from immediate holding company		3,800	-
Cash generated from financing activities		3,807	81
Effect of foreign exchange rate changes on cash		(92)	150
Decrease in cash		(13,048)	(503)
Cash, beginning of period		21,837	19,674
Cash, end of period		\$ 8,789	\$ 19,171

Supplemental cash flow information (Note 22)

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

SouthGobi Resources Ltd.

Notes to the Condensed Consolidated Interim Financial Statements

(Unaudited)

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

1. CORPORATE INFORMATION AND GOING CONCERN

SouthGobi Resources Ltd. is a publicly listed company incorporated in Canada with limited liability under the legislation of the Province of British Columbia and its shares are listed on the Toronto Stock Exchange (Symbol: SGQ) and Hong Kong Stock Exchange (Symbol: 1878). The company, together with its subsidiaries (collectively referred to as the “Company”), is an integrated coal mining, development and exploration company. The Company’s immediate parent company is Turquoise Hill Resources Ltd. (“Turquoise Hill”) and at June 30, 2014, Turquoise Hill owned approximately 56% of the outstanding common shares of the Company (Note 21). Turquoise Hill is controlled by Rio Tinto plc (“Rio Tinto”).

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

The head office, principal address and registered and records office of the Company is located at 354 – 200 Granville Street, Vancouver, British Columbia, Canada, V6C 1S4.

In order to manage coal inventories and to maintain efficient working capital levels, the Company’s mining activities at the Ovoot Tolgoi Mine remained fully curtailed from 1 January, 2013 until March 22, 2013, when the Company recommenced mining activities at the Ovoot Tolgoi Mine.

Going concern assumption

Several adverse conditions and material uncertainties cast significant doubt upon the going concern assumption. The Company had cash of \$8,789 and working capital (net current assets) of \$16,703 at June 30, 2014. However, the Company anticipates that coal prices in the People’s Republic of China (“China”) will remain under pressure in 2014, which will continue to impact the Company’s margins and liquidity. Therefore the Company is actively seeking additional sources of financing to continue operating and meet its objectives, while continuing to be focused on minimizing uncommitted capital expenditures while preserving the Company’s growth options. The Company is in discussions with various parties regarding potential funding solutions; however, there is no guarantee that an agreement will be reached. As of the date hereof, the Company expects to be able to secure such funding in order to pay the interest due under the CIC convertible debenture on November 19, 2014. If it does not do so, or if it fails to secure additional capital or otherwise restructure or refinance its business in order to address its cash requirements through June 30, 2015, then the Company is unlikely to have sufficient capital resources or cash flows from mining operations in order to satisfy its ongoing obligations and future contractual commitments, including cash interest payments due on the CIC convertible debenture. As a result, the Company may not be able to continue as a going concern. Therefore, the Company is actively seeking additional sources of financing to continue operating and meet its objectives.

SouthGobi Resources Ltd.

Notes to the Condensed Consolidated Interim Financial Statements

(Unaudited)

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

1. CORPORATE INFORMATION AND GOING CONCERN (CONTINUED)

The Company's consolidated financial statements have been prepared on a going concern basis which assumes that the Company will continue operating until at least June 30, 2015 and will be able to realize its assets and discharge its liabilities in the normal course of operations as they come due; however, in order to continue as a going concern, the Company must generate sufficient operating cash flows, secure additional capital or otherwise pursue a strategic restructuring, refinancing or other transaction to provide it with additional liquidity. If the Company fails to generate sufficient operating cash flows, secure additional capital or otherwise restructure or refinance its business in order to pay the interest due under the CIC convertible debenture on November 19, 2014, or if it fails to generate sufficient operating cash flows, secure additional capital or otherwise restructure or refinance its business in order to address its cash requirements through June 30, 2015, it will not have adequate liquidity to fund its operations and meet its obligations (including its debt payment obligations), it may not be able to continue as a going concern. If for any reason, the Company is unable to secure the additional sources of financing and continue as a going concern, then this could result in adjustments to the amounts and classifications of assets and liabilities in the Company's consolidated financial statements and such adjustments could be material.

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

2. RESTATEMENT OF PREVIOUSLY ISSUED FINANCIAL STATEMENTS

The comparative interim condensed consolidated financial statements and notes thereto for the three months ended June 30, 2013 have been restated to reflect a correction in the point of revenue recognition subsequent to the original issuance of the financial statements for that period, as more fully described below.

During 2013, the Company determined that certain revenue transactions were previously recognized in the Company's consolidated financial statements prior to meeting relevant revenue recognition criteria. These transactions related to coal that had been delivered to the customer's stockpile in a stockyard located within the 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.

As a result, on December 12, 2013, the Company issued restated consolidated annual financial statements as of and for the years ended December 31, 2012 and 2011 and the statement of financial position as at January 1, 2011.

The following tables reflect the correction in the point of revenue recognition on the affected line items in the previously issued interim condensed consolidated financial statements for the three and six months ended June 30, 2013:

SouthGobi Resources Ltd.

Notes to the Condensed Consolidated Interim Financial Statements

(Unaudited)

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

2. RESTATEMENT OF PREVIOUSLY ISSUED FINANCIAL STATEMENTS (CONTINUED)

Effect on consolidated statement of comprehensive income

	Three months ended			Six months ended		
	June 30, 2013			June 30, 2013		
	As previously reported	Adjustment	Restated	As previously reported	Adjustment	Restated
Revenue	\$ 374	\$ 5,755	\$ 6,129	\$ 3,633	\$ 6,894	\$ 10,527
Cost of sales	(12,466)	(5,011)	\$ (17,477)	(34,327)	(4,456)	(38,783)
Gross loss	(12,092)	744	\$ (11,348)	(30,694)	2,438	(28,256)
Other operating expenses	(14,877)	(48)	\$ (14,925)	(15,260)	(95)	(15,355)
Administration expenses	(4,024)	-	\$ (4,024)	(7,757)	-	(7,757)
Evaluation and exploration expenses	(221)	-	\$ (221)	(494)	-	(494)
Loss from operations	(31,214)	696	\$ (30,518)	(54,205)	2,343	(51,862)
Finance costs	(5,617)	-	\$ (5,617)	(10,608)	-	(10,608)
Finance income	3,366	-	\$ 3,366	4,136	-	4,136
Share of loss of joint venture	44	-	\$ 44	27	-	27
Loss before tax	(33,421)	696	\$ (32,725)	(60,650)	2,343	(58,307)
Current income tax expense	-	-	\$ -	(1)	-	(1)
Deferred income tax recovery	(241)	(175)	\$ (416)	2,087	(586)	1,501
Net loss attributable to equity holders of the Company	(33,662)	521	\$ (33,141)	(58,564)	1,757	(56,807)
Other comprehensive income	(930)	-	\$ (930)	-	-	-
Net comprehensive loss attributable to equity holders of the Company	(34,592)	521	\$ (34,071)	(58,564)	1,757	(56,807)
Basic loss per share	\$ (0.18)	\$ -	\$ (0.18)	\$ (0.32)	\$ 0.01	\$ (0.31)
Diluted loss per share	\$ (0.18)	\$ -	\$ (0.18)	\$ (0.32)	\$ 0.01	\$ (0.31)

Effect on consolidated statement of changes in equity

	Three months ended			Six months ended		
	June 30, 2013			June 30, 2013		
	As previously reported	Adjustment	Restated	As previously reported	Adjustment	Restated
Accumulated deficit						
Beginning balance	\$ (526,836)	\$ (3,860)	\$ (530,696)	\$ (501,934)	\$ (5,096)	\$ (507,030)
Net loss for the period	(33,662)	521	(33,141)	(58,564)	1,757	(56,807)
Closing balance	(560,498)	(3,339)	(563,837)	(560,498)	(3,339)	(563,837)
Total equity						
Beginning balance	\$ 585,303	\$ (3,861)	\$ 581,442	\$ 609,079	\$ (5,096)	\$ 603,983
Net loss for the period	(33,662)	521	(33,141)	(58,564)	1,757	(56,807)
Closing balance	550,729	(3,339)	547,390	550,729	(3,339)	547,390

The impact on opening accumulated deficit at January 1, 2013 reflects the cumulative impact on net loss attributable to equity holders of the Company for the years ended December 31, 2010, 2011 and 2012 of \$5,096.

SouthGobi Resources Ltd.

Notes to the Condensed Consolidated Interim Financial Statements

(Unaudited)

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

2. RESTATEMENT OF PREVIOUSLY ISSUED FINANCIAL STATEMENTS (CONTINUED)

Effect on consolidated statement of cash flows

	Six months ended		
	June 30, 2013		
	As previously reported	Adjustment	Restated
Loss before tax	\$ (60,650)	\$ 2,343	\$ (58,307)
Operating cash flows before changes in non-cash working capital items	(19,875)	2,343	(17,532)
Net change in non-cash working capital items	12,682	(2,343)	10,339

3. BASIS OF PREPARATION

3.1 Statement of compliance

These condensed consolidated interim financial statements, including comparatives, have been prepared in accordance with International Accounting Standard 34 "Interim Financial Reporting" using accounting policies in compliance with the International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") and Interpretations of the IFRS Interpretations Committee ("IFRIC").

The condensed consolidated interim financial statements of the Company for the six months ended June 30, 2014 were approved and authorized for issue by the Board of Directors of the Company on August 11, 2014.

3.2 Basis of presentation

These condensed consolidated interim financial statements have been prepared using accounting policies and methods of computation consistent with those applied in the Company's December 31, 2013 consolidated annual financial statements, except for those accounting policies which have changed as a result of the adoption of new and revised standards and interpretations as described below. These condensed consolidated interim financial statements do not include all the information and note disclosures required by IFRS for annual financial statements and therefore should be read in conjunction with the Company's annual consolidated financial statements for the year ended December 31, 2013.

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

SouthGobi Resources Ltd.

Notes to the Condensed Consolidated Interim Financial Statements

(Unaudited)

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

3. BASIS OF PREPARATION (CONTINUED)

3.3 Adoption of new and revised standards and interpretations

The Company has adopted the new and revised standards and interpretations issued by the IASB listed below effective January 1, 2014. The adoption of these standards did not have a material impact on the financial statements of the Company.

IFRS 10, IFRS 12 and IAS 27 (2011) Amendments	Amendments to IFRS 10, IFRS 12 and IAS 27 (2011) – Investment Entities
IAS 32 Amendments	Amendments to IAS 32 Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities
IAS 39 Amendments	Amendments to IAS 39 Financial Instruments: Recognition and Measurement – Novation of Derivatives and Continuation of Hedge Accounting
IFRIC 21	Levies

Recent accounting pronouncements

In May 2014, the IASB issued IFRS 15, Revenue from Contracts with Customers (“IFRS 15”), which establishes principles to address the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity’s contracts with customers. The required adoption date for IFRS 15 is the annual period beginning on or after January 1, 2017, with early adoption permitted. The Company is in the process of analyzing IFRS 15 and determining the effect on its consolidated financial statements as a result of adopting this standard.

3.4 Significant accounting judgments and estimates

Information about judgments and estimates in applying accounting policies that have the most significant effect on the amounts recognized in the Company’s consolidated financial statements are included in Note 3.22 to the Company’s December 31, 2013 consolidated annual financial statements. Except for the significant accounting judgments and estimates disclosed below, there were no significant changes to the significant accounting judgments and estimates from December 31, 2013.

Liquidity and going concern assumption

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

SouthGobi Resources Ltd.

Notes to the Condensed Consolidated Interim Financial Statements

(Unaudited)

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

3. BASIS OF PREPARATION (CONTINUED)

Several adverse conditions and material uncertainties cast significant doubt upon the going concern assumption. In order to continue as a going concern, the Company must generate sufficient operating cash flows, secure additional capital or otherwise pursue a strategic restructuring, refinancing or other transaction to provide it with additional liquidity. If the Company fails to generate sufficient operating cash flows, secure additional capital or otherwise restructure or refinance its business in order to pay the interest due under the CIC convertible debenture on November 19, 2014, or if it fails to generate sufficient operating cash flows, secure additional capital or otherwise restructure or refinance its business in order to address its cash requirements through June 30, 2015, it will not have adequate liquidity to fund its operations and meet its obligations (including its debt payment obligations), it may not be able to continue as a going concern (refer to Note 1).

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

Review of carrying value of assets and impairment charges

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

Ovoot Tolgoi Mine cash generating unit

The Company determined that an indicator of impairment existed for its Ovoot Tolgoi Mine cash generating unit as at June 30, 2014. The impairment indicator was the continued weakness in the Company's share price during the three months ended June 30, 2014 and the fact that the market capitalization of the Company, as at June 30, 2014, was less than the carrying value of its net assets.

Therefore, the Company conducted an impairment test whereby the carrying value of the Company's Ovoot Tolgoi Mine cash generating unit was compared to its "value in use" using a discounted future cash flow valuation model. The Company's Ovoot Tolgoi Mine cash generating unit carrying value was \$397,187 as at June 30, 2014.

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

- Long term real selling price of \$104 per tonne for semi-soft coking coal FOB Australia;
- Life-of-mine coal production and operating costs; and
- A pre-tax discount rate of 14.9% based on an analysis of market, country and Company specific factors.

SouthGobi Resources Ltd.

Notes to the Condensed Consolidated Interim Financial Statements

(Unaudited)

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

3. BASIS OF PREPARATION (CONTINUED)

Key sensitivities in the valuation model are as follows:

- For each 1% increase/(decrease) in the long term real selling price of semi-soft coal FOB Australia, the calculated value of the cash generating unit increases/(decreases) by approximately \$24,100/(\$24,100); and
- For each 1% increase/(decrease) in the pre-tax discount rate, the calculated value of the cash generating unit (decreases)/increases by approximately (\$22,100)/\$23,900.

The impairment analysis did not result in the identification of an impairment loss and no charge was required as at June 30, 2014. A decline of more than 2% in the long term real selling price of semi soft coking coal or an increase of more than 2% in the pre-tax discount rate may trigger an impairment charge on the cash generating unit. The Company believes that the estimates and assumptions incorporated in the impairment analysis are reasonable; however, the estimates and assumptions are subject to significant uncertainties and judgments.

Review of carrying value of the prepaid toll washing fees

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

During the year ended December 31, 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 coal from the Ovoot Tolgoi Mine. The agreement has a duration of 5-years from commencement and provides for an annual wet washing capacity of approximately 3.5 million tonnes of input raw coal.

Commercial operations at the Ejin Jinda wet washing facility have not commenced. The Company identified the results of a trial sample from the wet washing facility and the delay in starting the commercial operations at the wet washing facility as indicators of impairment for the prepaid toll washing fees which are part of the contract with Ejin Jinda. Based on updated estimates and assumptions related to wash yields from the facility and potential fees to early cancel the contract (Note 23), a \$30,152 impairment loss on the \$33,556 of prepaid toll washing fees was recorded in other operating expenses during the year ended December 31, 2013. During the quarter ended June 30, 2014, the Company recorded an additional impairment of \$3,404 against the prepaid toll washing fees to fully impair the deposit due to the continued delay in starting the commercial operations at the wet washing facility and the continued soft coal market in China.

SouthGobi Resources Ltd.

Notes to the Condensed Consolidated Interim Financial Statements

(Unaudited)

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

4. SEGMENTED INFORMATION

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

During the six months ended June 30, 2014, the Mongolian Coal Division had 5 active customers with the largest customer accounting for 30% of revenues, the second and the third largest customer both accounting for 26% of revenue, respectively.

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

	Mongolian Coal Division	Unallocated (i)	Consolidated Total
Segment assets			
As at June 30, 2014	\$ 461,689	\$ 6,543	\$ 468,232
As at December 31, 2013	490,949	15,257	506,206
Segment liabilities			
As at June 30, 2014	\$ 27,173	\$ 109,636	\$ 136,809
As at December 31, 2013	25,393	105,756	131,149
Segment loss			
For the three months ended June 30, 2014	\$ (16,163)	\$ (7,005)	\$ (23,168)
For the three months ended June 30, 2013	(25,354)	(7,787)	(33,141)
For the six months ended June 30, 2014	\$ (29,381)	\$ (14,542)	\$ (43,923)
For the six months ended June 30, 2013	(49,020)	(7,787)	(56,807)
Segment revenues			
For the three months ended June 30, 2014	\$ 6,691	\$ -	\$ 6,691
For the three months ended June 30, 2013	6,129	-	6,129
For the six months ended June 30, 2014	\$ 11,828	\$ -	\$ 11,828
For the six months ended June 30, 2013	10,527	-	10,527
Impairment charge on assets (ii)			
For the three months ended June 30, 2014	\$ 9,928	\$ -	\$ 9,928
For the three months ended June 30, 2013	14,038	3,067	17,105
For the six months ended June 30, 2014	\$ 17,209	\$ 1,766	\$ 18,975
For the six months ended June 30, 2013	16,200	3,067	19,267

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

(ii) The impairment charge on assets for the three and six months ended June 30, 2014 and 2013 relates to trade and other receivables (Note 11), prepaid expenses and deposits, inventories (Note 12) and investments (Note 13).

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4. SEGMENTED INFORMATION (CONTINUED)

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

	Mongolia	Hong Kong	Canada	Consolidated Total
Revenues				
For the three months ended June 30, 2014	\$ 6,691	\$ -	\$ -	\$ 6,691
For the three months ended June 30, 2013	6,129	-	-	6,129
For the six months ended June 30, 2014	\$ 11,828	\$ -	\$ -	\$ 11,828
For the six months ended June 30, 2013	10,527	-	-	10,527
Non-current assets				
As at June 30, 2014	\$ 405,332	\$ 47	\$ 5,243	\$ 410,622
As at December 31, 2013	422,679	81	7,237	429,997

5. COST OF SALES

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

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Operating expenses	\$ 6,754	\$ 5,988	\$ 12,317	\$ 9,209
Share-based compensation expense (Note 19)	127	(153)	143	(153)
Depreciation and depletion	2,061	2,037	4,540	2,587
Impairment of coal stockpile inventories (Note 12)	6,246	3,850	13,527	4,971
Cost of sales from mine operations	15,188	11,722	30,527	16,614
Cost of sales related to idled mine assets ⁽ⁱ⁾	4,898	5,755	7,925	22,169
Cost of sales	\$ 20,086	\$ 17,477	\$ 38,452	\$ 38,783

- (i) Cost of sales related to idled mine assets for the three months ended June 30, 2014 includes \$4,857 of depreciation expense (2013: \$5,716 of depreciation expenses). Cost of sales related to idled mine assets for the six months ended June 30, 2014 includes \$7,846 of depreciation expense (2013: \$16,872 of depreciation expenses). The depreciation expense relates to the Company's idled plant and equipment.

The Company's mining activities remained fully curtailed from January 1, 2013 until March 22, 2013, when the Company recommenced mining activities at the Ovoot Tolgoi Mine. The idled mine asset depreciation expense for the six months ended June 30, 2013 relates to the Company's idled plant and equipment during the curtailment of its mining activities. The idled mine asset depreciation expense for the three and six months ended June 30, 2014 relates to the Company's idled plant and equipment as the production plan during the three and six months ended June 30, 2014 did not fully utilize the Company's existing mining fleet.

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6. OTHER OPERATING EXPENSES

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

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Public infrastructure	\$ -	\$ 3	-	\$ 6
Sustainability and community relations	58	34	129	80
Foreign exchange loss/(gain)	(146)	26	(910)	391
Mark-to-market loss on available-for-sale financial asset (Note 13)	-	3,067	1,766	3,067
Loss on disposal of property, plant and equipment (Note 14)	-	566	-	566
Impairment of property, plant and equipment (Note 14)	277	4,299	277	4,299
Impairment of prepaid expenses and deposits	3,405	-	3,405	-
Impairment of materials and supplies inventories	-	6,930	-	6,930
Proceeds from disposal of mining license	(1,818)	-	(1,818)	-
Other	-	-	-	16
Other operating expenses	\$ 1,776	\$ 14,925	\$ 2,849	\$ 15,355

7. ADMINISTRATION EXPENSES

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

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Corporate administration	\$ 523	\$ 992	\$ 1,183	\$ 2,124
Professional fees	779	2,229	1,465	3,631
Salaries and benefits	825	643	1,553	1,607
Share-based compensation expense (Note 19)	94	126	225	274
Depreciation	32	34	64	121
Administration expenses	\$ 2,253	\$ 4,024	\$ 4,490	\$ 7,757

8. EVALUATION AND EXPLORATION EXPENSES

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

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Direct expenses	\$ 25	\$ 9	\$ 125	\$ 29
License fees	-	166	-	346
Share-based compensation expense (Note 19)	9	6	14	12
Overhead and other	73	40	140	107
Evaluation and exploration expenses	\$ 107	\$ 221	\$ 279	\$ 494

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9. FINANCE COSTS AND INCOME

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

	Three months ended, June 30,		Six months ended, June 30,	
	2014	2013	2014	2013
Interest expense on convertible debenture (Note 16)	\$ 5,021	\$ 5,073	\$ 9,986	\$ 10,031
Unrealized loss on FVTPL investments ⁽ⁱ⁾	8	473	48	468
Interest expense on line of credit facility	-	-	-	11
Interest expense on borrowing (Note 17)	24	-	24	-
Commitment fee and front end fee (Note 17)	133	-	133	-
Realized loss on disposal of FVTPL investments	5	43	5	43
Accretion of decommissioning liability	24	28	44	55
Finance costs	\$ 5,215	\$ 5,617	\$ 10,240	\$ 10,608

(i) FVTPL is defined as "fair value through profit or loss".

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

	Three months ended, June 30,		Six months ended, June 30,	
	2014	2013	2014	2013
Unrealized gain on embedded derivatives in convertible debenture (Note 16)	\$ 121	\$ 3,343	\$ 1,120	\$ 4,091
Interest income	6	23	14	45
Finance income	\$ 127	\$ 3,366	\$ 1,134	\$ 4,136

10. LOSS PER SHARE

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

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Net loss	\$ (23,168)	\$ (33,141)	\$ (43,923)	\$ (56,807)
Weighted average number of shares	187,313	181,963	187,313	181,954
Basic and diluted loss per share	\$ (0.12)	\$ (0.18)	\$ (0.23)	\$ (0.31)

Potentially dilutive items not included in the calculation of diluted loss per share include the convertible debenture (Note 16) and stock options (Note 19) that were anti-dilutive.

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11. TRADE AND OTHER RECEIVABLES

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

	As at	
	June 30, 2014	December 31, 2013
Trade receivables	\$ 561	\$ 1,818
Other receivables	335	760
Total trade and other receivables	\$ 896	\$ 2,578

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

	As at	
	June 30, 2014	December 31, 2013
Less than 1 month	\$ 34	\$ 396
1 to 3 months	586	1,321
3 to 6 months	9	141
Over 6 months	267	720
Total trade and other receivables	\$ 896	\$ 2,578

Included in trade and other receivables are amounts due from related parties which are further disclosed in Note 21. The amounts due from related parties are unsecured, interest free and repayable upon written notice from the Company.

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

12. INVENTORIES

The Company's inventories consist of the following amounts:

	As at	
	June 30, 2014	December 31, 2013
Coal stockpiles	\$ 12,237	\$ 8,305
Materials and supplies	30,022	31,983
Total inventories	\$ 42,259	\$ 40,288

As at June 30, 2014, the coal stockpiles includes inventory held by a third party of \$4,302. (December 31, 2013: nil). Cost of sales for the three and six months ended June 30, 2014 includes an impairment loss of \$6,246 and \$13,527, respectively, related to the Company's coal stockpile inventories (For three and six months ended June 2013: \$3,850 and \$4,971, respectively). As at June 30, 2014, \$10,468 of the Company's coal stockpile inventories are carried at their net realizable value (December 31, 2013: \$4,853).

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13. INVESTMENTS

The Company's investments consist of the following amounts:

	As at	
	June 30, 2014	December 31, 2013
Non-current investments at fair value		
Investment in Kangaroo Resources Limited ⁽ⁱ⁾	\$ 95	\$ 222
Investment in Aspire Mining Limited ⁽ⁱⁱ⁾	4,309	6,175
Non-current investment in joint venture		
Investment in RDCC LLC	24,514	24,205
	28,918	30,602
Total investments	\$ 28,918	\$ 30,602

(i) At June 30, 2014, the Company owned 0.3% of Kangaroo's issued and outstanding shares.

(ii) At June 30, 2014, the Company owned 18.8% of Aspire's issued and outstanding shares.

13.1 Investment in Kangaroo Resources Limited

Kangaroo Resources Limited ("Kangaroo") is a company listed on the Australian Securities Exchange. Kangaroo's primary focus is its coal projects in Indonesia. The Company classifies its investment in Kangaroo as a FVTPL financial asset with any change in value being recognized in profit or loss. During the three months ended June 30, 2014, the Company disposed of 7,347 shares of Kangaroo for gross proceeds of \$69. During the six months ended June 30, 2014, the Company disposed of 7,714 shares of Kangaroo for gross proceeds of \$74. For the three months ended June 30, 2014, the Company recognized an unrealized mark to market loss of \$8 related to its investment in Kangaroo (2013: unrealized loss of \$473). For the six months ended June 30, 2014, the Company recognized an unrealized mark to market loss of \$48 related to its investment in Kangaroo (2013: unrealized loss of \$468).

13.2 Investment in Aspire Mining Limited

Aspire Mining Limited ("Aspire") is a company listed on the Australian Securities Exchange. Aspire's primary focus is its mineral exploration and mining licenses in Mongolia, particularly those pertaining to the Ovoot Coking Coal Project. The Company classifies its investment in Aspire as an available-for-sale financial asset. For the three months ended June 30, 2014, the Company recognized an unrealized gain, net of tax, of \$414 in other comprehensive income (2013: impairment loss of \$3,067 recognized in other operating expenses). For the six months ended June 30, 2014, the Company recognized an impairment loss of \$1,766 in other operating expenses and an unrealized gain, net of tax, of \$414 in other comprehensive income (2013: impairment loss of \$3,067 recognized in other operating expenses).

13.3 Investment in RDCC LLC

The Company has a 40% interest in RDCC LLC, a joint venture. RDCC LLC has signed a concession agreement with the State Property Committee of Mongolia to construct a paved highway from the Company's Ovoot Tolgoi Mine to the Mongolia-China border. The concession agreement is structured as a 17-year build, operate and transfer agreement.

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13. INVESTMENTS (CONTINUED)

RDCC LLC accounts for the concession agreement in accordance with IFRIC 12 “Service Concession Arrangements” under the intangible asset model. In accordance with IFRIC 12, infrastructure associated with the concession agreement is recorded by RDCC LLC as an intangible asset. Construction revenue is recognized during the construction phase of the concession agreement as an exchange of construction services for the intangible asset and toll revenue is recognized during the operational phase of the concession agreement.

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

	Three months ended		Six months ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Balance, beginning of period	\$ 24,517	\$ 15,300	\$ 24,205	\$ 13,902
Funds advanced	-	164	338	1,579
Share of earnings/(losses) of joint venture	(3)	44	(29)	27
Balance, end of period	\$ 24,514	\$ 15,508	\$ 24,514	\$ 15,508

For the three and six months ended June 30, 2014, RDCC LLC recognized construction revenue of \$5,448 with a profit margin of \$nil related to the construction of the paved highway. For the three and six months ended June 30, 2014, RDCC LLC had a net loss of \$7 and \$72, respectively. For the three and six months ended June 30, 2013, RDCC LLC has a net earnings of \$109 and \$68, respectively.

14. PROPERTY, PLANT AND EQUIPMENT

The Company’s property, plant and equipment consist of the following amounts:

	Mobile equipment	Other operating equipment	Buildings and roads	Mineral properties	Construction in progress	Total
Cost						
As at December 31, 2013	\$ 363,689	\$ 28,350	\$ 72,214	\$ 127,068	\$ 6,276	\$ 597,597
Additions	1,643	157	14	6,402	-	8,216
Disposals	(826)	(50)	-	-	(35)	(911)
Impairment charges	-	-	-	-	(277)	(277)
Reclassifications	-	-	(34)	-	34	-
As at June 30, 2014	\$ 364,506	\$ 28,457	\$ 72,194	\$ 133,470	\$ 5,998	\$ 604,625
Accumulated depreciation						
As at December 31, 2013	\$ (138,627)	\$ (17,231)	\$ (27,454)	\$ (14,890)	\$ -	\$ (198,202)
Charge for the period	(20,608)	(1,371)	(2,921)	(692)	-	(25,592)
Eliminated on disposals	826	47	-	-	-	873
As at June 30, 2014	\$ (158,409)	\$ (18,555)	\$ (30,375)	\$ (15,582)	\$ -	\$ (222,921)
Carrying amount						
As at December 31, 2013	\$ 225,062	\$ 11,119	\$ 44,760	\$ 112,178	\$ 6,276	\$ 399,395
As at June 30, 2014	\$ 206,097	\$ 9,902	\$ 41,819	\$ 117,888	\$ 5,998	\$ 381,704

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14. PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

14.1 Prepayments on property, plant and equipment

As at June 30, 2014, the cost of the Company's property, plant and equipment includes \$39,805 of prepayments to vendors (December 31, 2013: \$41,240). The prepayments primarily relate to ordered but not yet delivered mobile equipment or mobile equipment delivered to the location of its intended use but not yet commissioned.

15. TRADE AND OTHER PAYABLES

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

	As at	
	June 30, 2014	December 31, 2013
Less than 1 month	\$ 14,392	\$ 28,786
1 to 3 months	3,462	554
3 to 6 months	48	367
Over 6 months	928	1,534
Total trade and other payables	\$ 18,830	\$ 31,241

Included in trade and other payables are amounts due to related parties which are further disclosed in Note 21.

16. CONVERTIBLE DEBENTURE

16.1 Key commercial terms

On November 19, 2009, the Company issued a convertible debenture to a wholly owned subsidiary of CIC for \$500,000. The convertible debenture bears interest at 8.0% per annum (6.4% payable semi-annually in cash and 1.6% payable annually in the Company's shares) and has a maximum term of 30 years. The convertible debenture is secured by a first charge over the Company's assets, including shares of its material subsidiaries. An event of default on the convertible debenture can be triggered as a result of certain encumbrances on the Company's assets (refer to Note 24.2).

The Company had the right to call for the conversion of up to \$250,000 of the debenture on the earlier of twenty four months after the issue date, if the conversion price was greater than Cdn\$10.66, or upon the Company achieving a public float of 25% of its common shares under certain agreed circumstances, if the conversion price was greater than Cdn\$10.66. On March 29, 2010, pursuant to the debenture conversion terms, the Company exercised this conversion right and completed the conversion of \$250,000 of the convertible debenture into 21,471 shares at a conversion price of \$11.64 (Cdn\$11.88).

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16. CONVERTIBLE DEBENTURE (CONTINUED)

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

16.2 Debt host and embedded derivatives

The convertible debenture is presented as a liability since it contains no equity components. The convertible debenture is a hybrid instrument, containing a debt host component and three embedded derivatives - the investor's conversion option, the issuer's conversion option and the equity based interest payment provision (the 1.6% share interest payment) (the "embedded derivatives"). The debt host component is classified as other-financial-liabilities and is measured at amortized cost using the effective interest rate method and the embedded derivatives are classified as FVTPL and all changes in fair value are recorded in profit or loss. The difference between the debt host component and the principal amount of the loan outstanding is accreted to profit or loss over the expected life of the convertible debenture.

The embedded derivatives were valued upon initial measurement and subsequent periods using a Monte Carlo simulation valuation model. A Monte Carlo simulation model is a valuation model that relies on random sampling and is often used when modeling systems with a large number of inputs and where there is significant uncertainty in the future value of inputs and where the movement of the inputs can be independent of each other. Some of the key inputs used by the Company in its Monte Carlo simulation include: the floor and ceiling conversion prices, the Company's common share price, the risk-free rate of return, expected volatility of the Company's common share price, forward foreign exchange rate curves (between the Cdn\$ and U.S. Dollar) and spot foreign exchange rates.

16.3 Valuation assumptions

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

	As at	
	June 30, 2014	December 31, 2013
Floor conversion price	Cdn\$8.88	Cdn\$8.88
Ceiling conversion price	Cdn\$11.88	Cdn\$11.88
Common share price	Cdn\$0.63	Cdn\$0.84
Historical volatility	70%	71%
Risk free rate of return	2.68%	3.11%
Foreign exchange spot rate (Cdn\$ to U.S. Dollar)	0.94	0.94
Forward foreign exchange rate curve (Cdn\$ to U.S. Dollar)	0.92 - 0.94	0.92 - 0.94

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16. CONVERTIBLE DEBENTURE (CONTINUED)

16.4 Presentation

Based on the Company's valuation as at June 30, 2014, the fair value of the embedded derivatives decreased by \$121 and \$1,120 compared to March 31, 2014 and December 31, 2013, respectively. The decrease was recorded as finance income for the three and six months ended June 30, 2014.

For the three months ended June 30, 2014, the Company recorded interest expense of \$5,021 related to the convertible debenture as a finance cost (2013: \$5,073). For the six months ended June 30, 2014, the Company recorded interest of \$9,985 related to the convertible debenture as a finance cost (2013: \$10,031). The interest expense consists of the interest at the contract rate and the accretion of the debt host component of the convertible debenture. To calculate the accretion expense, the Company uses the contract life of 30 years and an effective interest rate of 22.2%.

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

	Three months ended		Six months ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Balance, beginning of period	\$ 100,568	\$ 106,179	\$ 96,603	\$ 105,969
Interest expense on convertible debenture	5,021	5,073	9,985	10,031
Decrease in fair value of embedded derivatives	(121)	(3,343)	(1,120)	(4,091)
Interest paid	(7,934)	-	(7,934)	(4,000)
Balance, end of period	\$ 97,534	\$ 107,909	\$ 97,534	\$ 107,909

The convertible debenture balance consists of the following amounts:

	As at	
	June 30, 2014	December 31, 2013
Current convertible debenture		
Interest payable	\$ 4,285	\$ 2,301
Non-current convertible debenture		
Debt host	90,975	90,907
Fair value of embedded derivatives	2,274	3,395
	93,249	94,302
Total convertible debenture	\$ 97,534	\$ 96,603

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17. INTEREST-BEARING BORROWING

On May 25, 2014, the Company announced it has obtained a \$10,000 revolving credit facility from Turquoise Hill to meet its short term working capital requirements (the "Turquoise Hill Loan Facility"). The terms and conditions of this facility were filed on SEDAR (www.sedar.com) on June 2, 2014. The key commercial terms of the facility are as follows:

- maturity date of August 30, 2014;
- interest rate of one month US dollar LIBOR Rate in effect plus 11% margin per annum;
- commitment fee of 35% of interest rate payable quarterly in arrears on undrawn principal amount of facility;
- front end fee of \$100;
- draws subject to customary closing conditions and the Company's cash requirements in the ordinary course of business;
- facility is subject to certain mandatory prepayment and termination provisions; and
- the Company to continue to seek other funding alternatives.

As at June 30, 2014 the Company had drawn down \$3,800 under this facility. (December 31, 2013: nil). Included in the interest-bearing borrowing amounts due to related parties which are further disclosed in Note 21.

18. EQUITY

18.1 Share capital

The Company has authorized an unlimited number of common and preferred shares with no par value. At June 30, 2014, the Company had 187,317 common shares outstanding (December 31, 2013: 187,309) and no preferred shares outstanding (December 31, 2013: nil). The Company's volume weighted average share price for the six months ended June 30, 2014 was Cdn\$0.71 (2013: Cdn\$2.08).

18.2 Accumulated deficit and dividends

At June 30, 2014, the Company has accumulated a deficit of \$788,417 (December 31, 2013: \$744,494). No dividends have been paid or declared by the Company since inception.

19. SHARE-BASED PAYMENTS

19.1 Stock option plan

The Company has a stock option plan which permits the Board of Directors of the Company to grant options to acquire common shares of the Company at the volume weighted average closing price for the five days preceding the date of grant. The Company is authorized to issue stock options for a maximum of 10% of the issued and outstanding common shares pursuant to the stock option plan. The stock option plan permits the Board of Directors of the Company to set the terms for each stock option grant; however, the general terms of stock options granted under the plan include a maximum exercise period of 5 years and a vesting period of 3 years with 33% of the grant vesting on the first anniversary of the grant, 33% vesting on the second anniversary of the grant and 34% vesting on the third anniversary of the grant.

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19. SHARE-BASED PAYMENTS (CONTINUED)

For the six months ended June 30, 2014, the Company granted 482 stock options (2013: 62) to officers, employees, directors and other eligible persons at exercise prices ranging from Cdn\$0.65 to Cdn\$0.84 (2013: exercise price of Cdn\$2.10) and expiry dates ranging from January 13, 2019 to March 26, 2019 (2013: expiry date of March 27, 2018). The weighted average fair value of the options granted in the six months ended June 30, 2014 was estimated at \$0.24 (Cdn\$0.27) (2013: \$0.76, Cdn\$0.78) per option at the grant date using the Black-Scholes option pricing model.

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

	Six months ended	
	June 30,	
	2014	2013
Risk free interest rate	1.43%	1.20%
Expected life	3.5 years	3 years
Expected volatility ⁽ⁱ⁾	56%	58%
Expected dividend per share	\$nil	\$nil

- (i) Expected volatility has been calculated based on historical volatility of the Company's publicly traded shares over a period equal to the expected life of the options.

A share-based compensation expense of \$98 for the options granted in the six months ended June 30, 2014 (2013: \$44) will be amortized over the vesting period, of which \$18 was recognized in the six months ended June 30, 2014 (2013: \$11).

The total share-based compensation expense for the three months ended June 30, 2014 was \$230 (2013: recovery of \$21). Share-based compensation expense of \$94 (2013: \$126) has been allocated to administration expenses, \$127 (2013: recovery of \$153) has been allocated to cost of sales and \$9 (2013: \$6) has been allocated to evaluation and exploration expenses.

The total share-based compensation expense for the six months ended June 30, 2014 was \$381 (2013: \$133). Share-based compensation expense of \$224 (2013: \$274) has been allocated to administration expenses, \$143 (2013: recovery of \$153) has been allocated to cost of sales and \$14 (2013: \$12) has been allocated to evaluation and exploration expenses.

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19. SHARE-BASED PAYMENTS (CONTINUED)

19.2 Outstanding stock options

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

	Six months ended June 30, 2014		Six months ended June 30, 2013	
	Number of options	Weighted average exercise price (Cdn\$)	Number of options	Weighted average exercise price (Cdn\$)
Balance, beginning of period	2,583	\$ 8.48	7,507	\$ 9.72
Options granted	482	0.68	62	2.10
Options forfeited	(166)	1.79	(398)	7.53
Options expired	(751)	11.25	(4,026)	10.53
Balance, end of period	2,148	\$ 6.28	3,145	\$ 8.81

The stock options outstanding and exercisable as at June 30, 2014 are as follows:

Exercise price (Cdn\$)	Options Outstanding			Options Exercisable		
	Options outstanding	Weighted average exercise price (Cdn\$)	Weighted average remaining contractual life (years)	Options outstanding and exercisable	Weighted average exercise price (Cdn\$)	Weighted average remaining contractual life (years)
0.65 to 2.10	993	\$ 1.30	4.09	288	\$ 1.96	3.50
6.16 to 9.43	518	8.10	2.37	407	8.09	2.37
11.51 to 12.99	637	12.58	0.98	637	12.58	0.98
	2,148	\$ 6.28	2.75	1,332	\$ 8.91	1.95

20. FAIR VALUE MEASUREMENTS

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

The following table provides an analysis of the Company's financial instruments that are measured subsequent to initial recognition at fair value, grouped into Level 1 to 3 based on the degree to which the inputs used to determine the fair value are observable.

- Level 1 fair value measurements are those derived from quoted prices in active markets for identical assets or liabilities.
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1, that are observable either directly or indirectly.
- Level 3 fair value measurements are those derived from valuation techniques that include inputs that are not based on observable market data. As at June 30, 2014 and December 31, 2013, the Company did not have any Level 3 financial instruments.

SouthGobi Resources Ltd.

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20. FAIR VALUE MEASUREMENTS (CONTINUED)

Recurring measurements	As at June 30, 2014			
	Level 1	Level 2	Level 3	Total
Financial assets at fair value				
Investment in Aspire	\$ 4,309	\$ -	\$ -	\$ 4,309
Investment in Kangaroo	95	-	-	95
Total financial assets at fair value	\$ 4,404	\$ -	\$ -	\$ 4,404
Financial liabilities at fair value				
Convertible debenture - embedded derivatives	\$ -	\$ 2,274	\$ -	\$ 2,274
Total financial liabilities at fair value	\$ -	\$ 2,274	\$ -	\$ 2,274

Recurring measurements	As at December 31, 2013			
	Level 1	Level 2	Level 3	Total
Financial assets at fair value				
Investment in Aspire	\$ 6,175	\$ -	\$ -	\$ 6,175
Investment in Kangaroo	222	-	-	222
Total financial assets at fair value	\$ 6,397	\$ -	\$ -	\$ 6,397
Financial liabilities at fair value				
Convertible debenture - embedded derivatives	\$ -	\$ 3,395	\$ -	\$ 3,395
Total financial liabilities at fair value	\$ -	\$ 3,395	\$ -	\$ 3,395

There were no transfers between Level 1, 2 and 3 for the six months ended June 30, 2014.

21. RELATED PARTY TRANSACTIONS

During the six months ended June 30, 2014 and 2013, the Company had related party transactions with the following companies related by way of directors or shareholders in common:

- Turquoise Hill – Turquoise Hill is the Company's immediate parent company and at June 30, 2014 owned approximately 56% of the outstanding common shares of the Company. Turquoise Hill provides various administrative services to the Company on a cost-recovery basis.
- Rio Tinto – Rio Tinto is the Company's ultimate parent company and at June 30, 2014 Rio Tinto controlled Turquoise Hill. The Company recovers administration and other costs incurred on behalf of Rio Tinto on a cost-recovery basis. Rio Tinto recovers from the Company the costs of salaries and benefits of employees assigned to work for the Company and recovers legal and professional fees from the Company in respect of the internal and tripartite committees referred to in section 6 "Regulatory Issues and Contingencies".
- Global Mining Management ("GMM") – On October 31, 2013, the Company and Turquoise Hill ceased being shareholders of GMM, a private company. GMM was owned equally by seven companies, two of which included the Company and Turquoise Hill. GMM provided administration, accounting and other office services to the Company on a cost-recovery basis. The provision of these services ceased on October 31, 2013.

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21. RELATED PARTY TRANSACTIONS (CONTINUED)

- 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.

21.1 Related party expenses

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

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
	Corporate administration	\$ 161	\$ 228	\$ 373
Salaries and benefits	350	295	900	482
Finance cost	157	-	157	-
Related party expenses	\$ 668	\$ 523	\$ 1,430	\$ 862

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

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
	GMM	\$ -	\$ 5	\$ -
Turquoise Hill	227	62	241	99
Rio Tinto	358	276	911	389
Turquoise Hill Singapore	83	180	278	317
Related party expenses	\$ 668	\$ 523	\$ 1,430	\$ 862

21.2 Related party expense recoveries

The Company’s expenses recovered from related parties consist of the following amounts:

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
	Corporate administration	\$ 17	\$ -	\$ 17

The Company’s related party expense recoveries relate to the following related parties:

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
	Turquoise Hill	17	-	17
Rio Tinto	-	-	-	7
Related party expense recovery	\$ 17	\$ -	\$ 17	\$ 7

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21. RELATED PARTY TRANSACTIONS (CONTINUED)

21.3 Related party assets

The assets of the Company include the following amounts due from related parties:

	As at	
	June 30, 2014	December 31, 2013
Amounts due from GMM	\$ -	\$ 74
Total assets due from related parties	\$ -	\$ 74

21.4 Related party liabilities

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

	As at	
	June 30, 2014	December 31, 2013
Amounts payable to Rio Tinto	\$ 7,539	\$ 1,375
Accounts payable to Turquoise Hill Singapore	174	-
Accounts payable to Turquoise Hill	3,904	34
Total liabilities due to related parties	\$ 11,617	\$ 1,409

Included in the accounts payable to Turquoise Hill, the Company had interest-bearing borrowings of \$3,800 with related parties as at June 30, 2014 (December 31, 2013: nil). Details are further disclosed in Note 17.

22. SUPPLEMENTAL CASH FLOW INFORMATION

22.1 Net change in non-cash working capital items

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

	Six months ended June 30,	
	2014	2013
Increase in inventories	\$ (7,121)	\$ (2,828)
Decrease/(increase) in trade and other receivables	1,436	(891)
Decrease in prepaid expenses and deposits	5,840	8,534
Increase/(decrease) in trade and other payables	(13,290)	5,774
Increase/(decrease) in deferred revenue	12,995	(250)
Net change in non-cash working capital items	\$ (140)	\$ 10,339

SouthGobi Resources Ltd.

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23. COMMITMENTS FOR EXPENDITURE

As at June 30, 2014, the Company's commitments for expenditure that have not been disclosed elsewhere in the consolidated financial statements are as follows:

	As at June 30, 2014			
	Within 1 year	2-3 years	Over 3 years	Total
Capital expenditure commitments	\$ 18,867	\$ 7,820	\$ -	\$ 26,687
Operating expenditure commitments ⁽ⁱ⁾	24,249	1,980	406	26,635
Commitments	\$ 43,116	\$ 9,800	\$ 406	\$ 53,322

(i) Operating expenditure commitments include \$17,600 of fees related to the Company's toll wash plant agreement with Ejinaqi Jinda Coal Industry Co. Ltd. This amount reflects the minimum expenditure due under this agreement.

24. CONTINGENCIES

24.1 Governmental and regulatory 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 the Company 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 formal notice that the IAAC investigation is completed. The IAAC has not formally accused any current or former Company employees of breach of Mongolia's anti-corruption laws.

A report issued by the experts appointed by the SIA on June 30, 2013 and again in January 2014 has recommended that the accusations of money laundering as alleged against the Company's three former employees be withdrawn. However, to date, the Company has not received notice or legal document confirming such withdrawal as recommended by the experts appointed by the SIA.

A third investigation ordered by the SIA and conducted by the National Forensic Center ("NFC") into alleged violations of Mongolian taxation law was concluded at the end of January 2014. The report with conclusions of the investigations by the NFC has been provided to the Prosecutor General of Mongolia. The Prosecutor General has issued criminal charges against the three former employees and the Company's Mongolian subsidiary SouthGobi Sands LLC may be held liable as "civil defendant" for alleged violations of Mongolian taxation law. The case was transferred to a Court of Justice for review by a judge in April 2014. On May 12, 2014, the Company was advised that the appointed judge has concluded that the investigation on the case was incomplete and has ordered to return the case to the General Prosecutor for additional investigation. As announced by the Company on June 24, 2014, the Company has been informed that the additional investigation has been completed and the case was transferred back to the First Instance 2nd District Court which has set the trial date to June 30, 2014. Following the initial appearances before the court by all concerned parties, the trial date for the case has been deferred until August 25, 2014.

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24. CONTINGENCIES (CONTINUED)

The likelihood or consequences of an outcome or any action taken against SouthGobi Sands LLC as “civil defendant” are uncertain and unclear at this time but could include financial or other penalties, which could be material, and which could have a material adverse effect on the Company.

The Company, including its Mongolian subsidiary SouthGobi Sands LLC, has prepared its financial statements in compliance with IFRS, and lodged all its tax returns in the required format under Mongolian tax law. During the investigative period, which has been ongoing since May 2012, the Company devoted considerable internal resources in reviewing and responding to the allegations raised through the investigations by the relevant authorities. The Company views these accusations as unfounded and dispute these accusations and the procedures and conclusions of the investigations that led to these accusations and will vigorously defend itself and its former three (3) employees against these charges.

At this point, the three former employees continue to be subject to a travel ban. SouthGobi Sands LLC is designated as a “civil defendant” in connection with the tax evasion allegations, and may potentially be held financially liable for the alleged criminal misconduct of its former employees under Mongolian Law.

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 \$1,508 held in local bank accounts, in connection with its continuing investigation of these allegations. This \$1,508 is included within the cash balance in the Company’s financial statements. 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. The Company will continue to take all appropriate steps to protect its ability to conduct its business activities in the ordinary course.

In the opinion of management of the Company, at June 30, 2014 a provision for this matter is not required.

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

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24. CONTINGENCIES (CONTINUED)

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.

24.3 Internal investigations

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

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

In the opinion of management of the Company, at June 30, 2014 a provision for this matter is not required.

24.4 Class action lawsuit

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

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

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24. CONTINGENCIES (CONTINUED)

The Company disputes and will vigorously defend itself against these claims through independent Canadian litigation counsel retained by the Company and the other defendants for this purpose. Due to the inherent uncertainties of litigation, it is not possible to predict the final outcome of the Ontario Action or determine the amount of any potential losses, if any. However, in the opinion of management of the Company, at June 30, 2014 a provision for this matter is not required.

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ADDITIONAL STOCK EXCHANGE INFORMATION

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

A1. TAXATION ON PROFITS

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

For the six months ended June 30, 2014 the Company recorded current income tax expense of \$546 (2013: \$1) related to withholding tax and assessable profit derived from Mongolia at prevailing rates. For the six months ended June 30, 2014, the Company did not record any deferred income tax expenses (2013: tax recovery of \$1,501) related to its Mongolian operations.

A2. FINANCIAL INSTRUMENTS

Cash

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

	As at	
	June 30, 2014	December 31, 2013
Denominated in U.S. Dollars	\$ 7,898	\$ 15,912
Denominated in Chinese Renminbi	321	4,888
Denominated in Mongolian Tugriks	468	632
Denominated in Canadian Dollars	73	200
Denominated in Hong Kong Dollars	9	182
Denominated in Australian Dollars	20	23
Cash	\$ 8,789	\$ 21,837

Exposure to fluctuations in foreign exchange rates

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

	As at	
	June 30, 2014	December 31, 2013
Increase / decrease in foreign exchange rate against US Dollar		
+5%	\$ (474)	\$ 59
-5%	474	(59)

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A3. COMPLIANCE WITH THE CODE ON CORPORATE GOVERNANCE PRACTICES

The Company has, throughout the six months ended June 30, 2014, applied the principles and complied with the requirements of its corporate governance practices as defined by the Board of Directors and all applicable statutory, regulatory and stock exchange listings standards.

A4. COMPLIANCE WITH MODEL CODE

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

The Board of Directors confirms that all of the Directors of the Company have complied with the required policies in the Company's Corporate Disclosure, Confidentiality and Securities Trading policy throughout the six months ended June 30, 2014.

A5. DIRECTORS' INTERESTS IN SHARES AND SHARE OPTIONS

As at June 30, 2014, the interests of the Company's directors in the shares and share options of the Company and its associated corporations are presented in the following tables.

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A5. DIRECTORS' INTERESTS IN SHARES AND SHARE OPTIONS (Continued)

Shares⁽ⁱ⁾

Name	Name of company	Nature of interest	Shares held	Percentage interest in the
Kay Priestly	SouthGobi Resources Ltd.	N/A	Nil	Nil
	Turquoise Hill Resources Ltd.	Direct	12,000	0.00%
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	Direct	59,961	0.00%
K. Ross Tromans	SouthGobi Resources Ltd.	N/A	Nil	Nil
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	Direct	30,696	0.00%
	Rio Tinto plc	N/A	Nil	Nil
Bold Baatar	SouthGobi Resources Ltd.	N/A	Nil	Nil
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	N/A	Nil	Nil
Pierre Lebel	SouthGobi Resources Ltd.	Direct	5,100	0.00%
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	N/A	Nil	Nil
André Deepwell	SouthGobi Resources Ltd.	Direct/indirect	45,000	0.02%
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	N/A	Nil	Nil
Gordon Lancaster	SouthGobi Resources Ltd.	N/A	Nil	Nil
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	N/A	Nil	Nil
Kelly Sanders	SouthGobi Resources Ltd.	N/A	Nil	Nil
	Turquoise Hill Resources Ltd.	N/A	Nil	Nil
	Rio Tinto Limited	N/A	Nil	Nil
	Rio Tinto plc	Direct	76,739	0.00%

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

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A5. DIRECTORS' INTERESTS IN SHARES AND SHARE OPTIONS (Continued)

Options ⁽ⁱ⁾

<u>Name</u>	<u>Name of company</u>	<u>Number of options held</u>
Kay Priestly	SouthGobi Resources Ltd.	Nil
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	6,298
K. Ross Tromans	SouthGobi Resources Ltd.	Nil
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	5,583
	Rio Tinto plc	Nil
Bold Baatar	SouthGobi Resources Ltd.	Nil
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil
Pierre Lebel	SouthGobi Resources Ltd.	115,000
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil
André Deepwell	SouthGobi Resources Ltd.	110,000
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil
Gordon Lancaster	SouthGobi Resources Ltd.	220,000
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	Nil
Kelly Sanders	SouthGobi Resources Ltd.	Nil
	Turquoise Hill Resources Ltd.	Nil
	Rio Tinto Limited	Nil
	Rio Tinto plc	9,601

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