SouthGobi Resources Ltd.

Management's Discussion and Analysis of Financial Condition and Results of Operations

June 30, 2014

(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 Company's expectations of sufficient liquidity and capital resources to meets its ongoing obligations and future contractual commitments; including the ability for the Company to continue to meet the requirements for further draw down under the revolving loan facility from Turquoise Hill Resources Ltd ("Turquoise Hill"), the Company's ability to secure additional and immediate funding, to meet its obligations under the China Investment Corporation ("CIC") convertible debenture as the same become due, the estimates and assumptions included in the Company's impairment analysis; the ability of the Company to increase its market penetration in the People's Republic of China ("China"); the ability for higher-ash product to be sold as a thermal coal product; the ability to preserve liquidity and continue on a sustainable basis; the Company's expectation that its royalty per tonne calculated under the new "flexible tariff" royalty regime will decrease compared to the prior reference price royalty regime; the ability of the Company to meet the targeted annual capacity of run-of-mine production; the ability of the Company to successfully review the utilization of the wet washing facility and enhance the quality of its coal products through wet washing; the possibility of the CIC convertible debenture and all accrued and unpaid interest becoming immediately due; the continued pressure on the coal prices in China, and the related impact on the Company's margins and liquidity; the outcome of the issues described in the section "Regulatory Issues and Contingencies"; statements regarding the outlook for 2014; the completion of the share purchase transaction between Turquoise Hill and National United Resources Holdings Limited ("NUR"); statements regarding the Company's objectives for 2014 and beyond; the statement that completion of the paved highway is expected by the end of 2014; the statement that the capacity of the paved highway is in excess of 20 million tonnes of coal per year; and other statements that are not historical facts. Except as required by law, the Company undertakes no obligation to update forward-looking statements if circumstances or management's estimates or opinions should change. The reader is cautioned not to place undue reliance on forward-looking statements.

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INTRODUCTION

This Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") of SouthGobi Resources Ltd. (which, together with its subsidiaries, is collectively referred to as the "Company") should be read in conjunction with the interim condensed consolidated financial statements of the Company and the notes thereto for the three and six months ended June 30, 2014. The Company's interim condensed consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board and Interpretations of the IFRS Interpretations Committee.

The functional currency of all of the Company's operations is the U.S. Dollar. All figures in this MD&A are presented in U.S. Dollars unless otherwise stated.

Disclosure of a scientific or technical nature in this MD&A, as derived from the Ovoot Tolgoi, Soumber, and Zag Suuj Technical Reports, in respect of each of the Company's material mineral projects was prepared by or under the supervision of the Qualified Persons listed below. Copies of the Ovoot Tolgoi Technical Report (dated March 19, 2012), the Soumber Technical Report (dated March 25, 2013) and the Zag Suuj Technical Report (dated March 25, 2013) are available on SEDAR at www.sedar.com:

Property	Qualified Persons	Field of Expertise	Relationship to Company
Ovoot Tolgoi	Merryl Peterson	Resources	Independent Consultant
Ovoot Tolgoi	Robert Mackenzie	Reserves	Independent Consultant
Ovoot Tolgoi	Ross Seedsman	Geotechnical	Independent Consultant
Ovoot Tolgoi	David Morris	Dry Coal Processing	Independent Consultant
Ovoot Tolgoi	Michael Evans	Wet Coal Processing	Independent Consultant
Soumber	Merryl Peterson	Resources	Independent Consultant
Zag Suuj	Merryl Peterson	Resources	Independent Consultant

Other disclosures of a scientific or technical nature in this MD&A (other than such information relating to Aspire Mining Limited ("Aspire"), which information was taken from Aspire's public disclosure record) in respect of the Ovoot Tolgoi mine and the Soumber project were prepared by employees of the Company and reviewed by Robert Mackenzie, an employee of RungePincockMinarco, a registered member and Chartered Professional (Mining) of the Australasian Institute of Mining and Metallurgy (Member No 103878) and a Qualified Person, as that term is defined in National Instrument 43-101 of the Canadian Securities Administrators ("NI 43-101"). Robert Mackenzie was the Qualified Person responsible for overall preparation of and the Coal Reserve estimates in the March 2012 Technical Report for Ovoot Tolgoi.

1. OVERVIEW

The Company is an integrated coal mining, development and exploration company. The Company's common shares trade on the Toronto Stock Exchange ("TSX") under the symbol SGQ and on the Hong Kong Stock Exchange ("HKEX") under the stock code symbol 1878. The Company'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. 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 the following significant development projects, the Ovoot Tolgoi Underground Deposit, the Soumber Deposit and the Zag Suuj Deposit. These projects are located in the Umnugobi Aimag (South Gobi Province) of Mongolia, within 150 kilometers ("km") of each other and in close proximity to the Mongolia-China border. The Ovoot Tolgoi Mine, together with the Ovoot Tolgoi Underground Deposit, forms the Ovoot Tolgoi Complex. The Company owns a 100% interest in these coal projects.

The Ovoot Tolgoi Mine, strategically located approximately 40km from the Shivee Khuren-Ceke crossing at the Mongolia-China border ("Shivee Khuren Border Crossing"), is the Company's flagship asset. The Company commenced mining at the Ovoot Tolgoi Mine in 2008 and the Company sells coal at the mine-gate to Chinese customers. Ceke, at the Chinese side of the Shivee Khuren Border Crossing, is a major Chinese coal distribution terminal with rail connections to key coal markets in China.

Saleable products from the Ovoot Tolgoi Mine primarily include the SouthGobi standard ("Standard") and SouthGobi premium ("Premium") semi-soft coking coal products. Some higher-ash product is sold as a thermal coal product as and when the market allows.

COAL RESERVES *(millions of tonnes)* [(i)]

Property	Proven	Probable	Total
Ovoot Tolgoi Mine	**119**	**57**	**176**

COAL RESOURCES *(millions of tonnes)* [(i)]

Property	Measured	Indicated	Measured & Indicated	Inferred
Ovoot Tolgoi Mine	133	60	193	24
Ovoot Tolgoi Underground	66	43	109	62
Soumber Deposit	63	110	173	123
Zag Suuj Deposit	-	22	22	84
Total coal resources	**262**	**235**	**497**	**293**

(i) *As at June 30, 2014. Reserves and resources estimates have been prepared in compliance with NI 43-101. Coal resources are inclusive of coal reserves. Details of the assumptions and parameters used to estimate the reserves and resources and information on data verification are set out in the Annual Information Form dated March 24, 2014, and available at www.sedar.com.*

As at June 30, 2014, the Company owned 18.8%[1] of the outstanding common shares of 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 its Ovoot Coking Coal Project.

As at June 30, 2014, the Company employed 403 employees.

[1] Calculation based on number of Aspire common shares outstanding according to their public announcements available at www.aspireminninglimited.com.

Significant Events and Highlights

The Company's significant events and highlights for the three months ended June 30, 2014 and subsequent period to August 11, 2014 are as follows:

- The Company continues to operate under difficult market conditions. Coal prices in China declined further in the second quarter compared to the first quarter of 2014 in response to excess seaborne and Chinese domestic supply. The decline in coal prices has been partially offset by the increase in the Company's volumes in the second quarter compared to the seasonally slow first quarter.

- Production decreased to 0.55 million tonnes of raw coal in the second quarter of 2014 compared to production of 0.64 million tonnes of raw coal in the first quarter of 2014.This decrease in production is due to the Company's decision in June in response to current market conditions to reduce its production and place approximately half of its workforce in furlough. This furlough is anticipated to remain in place until the end of August subject to market conditions.

- On May 25, 2014, the Company announced it obtained a $10 million revolving credit facility from Turquoise Hill to meet its short term working capital requirements with a maturity date of August 30, 2014. At June 30, 2014 the Company had drawn down $3.8 million under this facility.

- The Company completed the sale of Tsagaan Tolgoi mining license in the second quarter of 2014. The net proceeds generated for the Company after taxes and disposal costs was $1.3 million and was received in April 2014.

- The trial date for the tax investigation case against the Company's Mongolian subsidiary SouthGobi Sands LLC and three of its former employees as detailed in the Company's announcement of June 24, 2014 has been deferred until August 25, 2014.

- On June 19, 2014, the Takeovers and Mergers Panel of Hong Kong's Securities and Futures Commission determined that the Company should be considered a public company in Hong Kong for the purposes of the Codes on Takeovers and Mergers and Share Purchases in Hong Kong (the "Takeovers Code"). The Takeovers Code now applies to the Company.

- On July 30, 2014 the Company announced Turquoise Hill entered into an agreement with National United Resources Holdings Limited ("NUR") to sell shares representing 29.95% of the Company's total common shares. The closing of this transaction is subject to certain conditions, including the approval of both the HKEX as well as NUR's shareholders. Turquoise Hill expects the closing to occur no later than November 30, 2014.

- The Company announces Mr. Brett Salt, Chief Commercial Officer, has resigned with an effective date of October 1, 2014. Mr. Salt has accepted a new role with another company. The Company will announce its new sales and marketing structure in due course.

2. OVERVIEW OF OPERATIONAL DATA AND FINANCIAL RESULTS

Summary of Operational Data

	Three months ended June 30, 2014	Three months ended June 30, 2013	Six months ended June 30, 2014	Six months ended June 30, 2013
Sales Volumes, Prices and Costs				
Premium semi-soft coking coal				
Coal sales *(millions of tonnes)*	**-**	0.21	**-**	0.29
Average realized selling price *(per tonne)* (i)	**$ -**	$ 32.46	**$ -**	$ 35.82
Standard semi-soft coking coal				
Coal sales *(millions of tonnes)*	**0.12**	-	**0.41**	-
Average realized selling price *(per tonne)* (i)	**$ 20.33**	$ -	**$ 21.52**	$ -
Thermal coal				
Coal sales *(millions of tonnes)*	**0.51**	0.11	**0.61**	0.31
Average realized selling price *(per tonne)* (i)	**$ 10.72**	$ 13.98	**$ 10.94**	$ 13.78
Total				
Coal sales *(millions of tonnes)*	**0.63**	0.32	**1.02**	0.60
Average realized selling price *(per tonne)* (i)	**$ 12.52**	$ 26.26	**$ 15.22**	$ 24.70
Raw coal production *(millions of tonnes)*	**0.55**	0.17	**1.19**	0.19
Direct cash costs of product sold *(per tonne)* (ii)	**$ 8.23**	$ 11.49	**$ 9.08**	$ 10.90
Mine administration cash costs of product sold *(per tonne)* (ii)	**$ 2.49**	$ 7.14	**$ 3.00**	$ 4.53
Total cash costs of product sold *(per tonne)* (ii)	**$ 10.72**	$ 18.63	**$ 12.08**	$ 15.43
Other Operational Data				
Production waste material moved *(millions of bank cubic meters)*	**2.17**	2.71	**4.72**	3.10
Strip ratio *(bank cubic meters of waste material per tonne of coal produced)*	**3.97**	15.55	**4.00**	16.40
Lost time injury frequency rate (iii)	**0.15**	-	**0.15**	-

(i) Average realized selling price excludes royalties and selling fees.
(ii) A non-IFRS financial measure, see section 3. Cash costs of product sold exclude idled mine asset cash costs.
(iii) Per 200,000 man hours and calculated based on a rolling 12 month average.

Overview of Operational Data

The Company continues to operate under difficult market conditions which have affected the Company's results for the second quarter and first six months of 2014 in respect of sales prices, mix and volumes.

For the three months ended June 30, 2014

During the second quarter of 2014, the Company shipped 0.91 million tonnes of coal. Revenue was recognized in respect of 0.63 million tonnes with the remaining 0.28 million tonnes expected to meet all revenue recognition requirements in the second half of 2014.

In light of the current market, the Company continued to pace its production with current demand. As a result, the Company operated significantly below its operating capacity in the second quarter of 2014. In June 2014 following a review of operations, the Company further reduced its production and placed approximately half of its workforce in furlough.

The production in the second quarter of 2014 was higher than the second quarter of 2013 as the Company primarily moved waste material (overburden) and exposed coal in pit in preparation for sales anticipated in subsequent quarters of 2013.

On June 26, 2014, the Ovoot Tolgoi mine site region experienced torrential rain and flooding which temporarily interrupted mining operations. The region was subject to further rainfall in July. The impact on the Company's operations is not expected to be material.

The Company continues to maintain a strong safety record. It recorded one lost time injury on April 8, 2014 and has at June 30, 2014 a lost injury time frequency rate of 0.15 per 200,000 man hours based on a rolling 12 month average.

For the six months ended June 30, 2014

During the first six months of 2014, the Company shipped 1.30 million tonnes of coal. Revenue was recognized in respect of 1.02 million tonnes with the remaining 0.28 million tonnes expected to meet all revenue recognition requirements in the second half of 2014.

The production in the first six months of 2014 was higher than the first six months of 2013 due to the full curtailment of the Company's mining operations from the second quarter of 2012 through to March 22, 2013. Furthermore, in the second quarter of 2013, the Company primarily moved waste material (overburden) and exposed coal in pit in preparation for sales anticipated in subsequent quarters of 2013.

Summary of Financial Results

	Three months ended June 30,		Six months ended June 30,	
$ in thousands, except per share information	**2014**	**2013**	**2014**	**2013**
Revenue [(i),(ii)]	**$ 6,691**	$ 6,129	**$ 11,828**	$ 10,527
Cost of sales [(ii)]	**(20,086)**	(17,477)	**(38,452)**	(38,783)
Gross loss excluding idled mine asset costs	**(8,497)**	(5,593)	**(18,699)**	(6,087)
Gross loss including idled mine asset costs	**(13,395)**	(11,348)	**(26,624)**	(28,256)
Other operating expenses	**(1,776)**	(14,925)	**(2,849)**	(15,356)
Administration expenses	**(2,253)**	(4,024)	**(4,490)**	(7,757)
Evaluation and exploration expenses	**(107)**	(221)	**(279)**	(494)
Loss from operations	**(17,531)**	(30,518)	**(34,242)**	(51,862)
Finance costs	**(5,215)**	(5,617)	**(10,240)**	(10,608)
Finance income	**127**	3,366	**1,134**	4,136
Share of earnings/(losses) of joint venture	**(3)**	44	**(29)**	27
Income tax (expense)/recovery	**(546)**	(416)	**(546)**	1,500
Net loss	**(23,168)**	(33,141)	**(43,923)**	(56,807)
Basic loss per share	**$ (0.12)**	$ (0.18)	**$ (0.23)**	$ (0.31)
Diluted loss per share	**$ (0.12)**	$ (0.18)	**$ (0.23)**	$ (0.31)

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

Royalty regime in Mongolia

During a trial period from October 1, 2012 to March 31, 2013, the royalty imposed on coal sales was determined using the actual contracted sales price per tonne. The Government of Mongolia changed the royalty regime effective April 1, 2013. From April 1, 2013 to March 31, 2014, the royalty on all coal sales exported out of Mongolia was based on a set reference price per tonne published monthly by the Government of Mongolia. As a result, in the second quarter of 2013, the Company was subject to an average 7% royalty based on a weighted average reference price of $70.83 per tonne while the Company's average realized selling price was $26.26 per tonne.

The Government of Mongolia changed the royalty regime effective April 1, 2014. Under the new "flexible tariff" royalty regime, the royalty per tonne for export coal sales will be calculated based on the actual contracted sales price per tonne, whereby the contracted sales price includes the costs of transporting the coal to the Mongolia-China border. If transportation costs are not included in the contracted sales price between a buyer and seller, the following costs are required to be included in the contracted sales price for purposes of calculating the royalty per tonne: transportation costs and costs associated with transportation such as customs documentation fees, insurance, loading and unloading costs. In the event the actual contracted sales price calculated as described above differs by more than 10% from the contracted sales price of coal products with the same classification and quality being exported by other legal entities in Mongolia through the same border crossing, the calculated contracted sales price shall be deemed non-market under Mongolian tax law and the royalty per tonne will be calculated based on a reference price that will be determined by the Government of Mongolia.

The Company currently sells coal from the Ovoot Tolgoi Mine ex mine gate and the coal is exported through the Shivee Khuren Border Crossing. The Company's average realized selling price excludes transportation costs.

On July 4, 2014, the Government of Mongolia made further amendment to the royalty regime. From July 4, 2014 onwards the royalty is to be initially calculated and paid monthly based on the Government reference price. On a quarterly basis the royalty amount would be adjusted to reflect the contracted sales price and additional documentation would have to be submitted to the Mongolian Tax Authority. Once the quarterly statement has been approved by the Mongolian Tax Authority, any adjustments between the monthly payments for the quarter and the quarterly submission are adjusted in the next months' royalty calculation.

Overview of Financial Results

For the three months ended June 30, 2014

The Company recorded a $17.5 million loss from operations in the second quarter of 2014 compared to a $30.5 million loss from operations in the second quarter of 2013. The second quarter of 2014 was impacted by continuing difficult market conditions which resulted in lower sales prices compared to the second quarter of 2013. This reduction in prices was offset by higher sales volumes, lower royalty expenses, lower idled mine asset costs and lower impairment losses in the second quarter of 2014 compared to the second quarter of 2013.

Revenue was $6.7 million in the second quarter of 2014 compared to $6.1 million in the second quarter of 2013. The Company sold 0.63 million tonnes of coal at an average realized selling price of $12.52 per tonne in the second quarter of 2014 compared to sales of 0.32 million tonnes at an average realized selling price of $26.26 per tonne in the second quarter of 2013. Revenue increased in the second quarter of 2014 compared to the second quarter of 2013 primarily due to higher sales volumes. The average realized selling price was impacted by the product mix in the second quarter of 2014. The product mix in the second quarter of 2014 primarily consisted of thermal coal with limited Standard semi-soft coking coal compared to a mix of Premium semi-soft coking coal and thermal coal in the second quarter of 2013.

The Company's revenue is presented net of royalties and selling fees. Following the change in the Mongolia's royalty regime starting April 1, 2014, the Company's effective royalty rate for the second quarter of 2014, based on the Company's average realized selling price of $12.52 per tonne, was 8.1% or $1.00 per tonne. In the second quarter of 2013, the Company was subject to an average 7% royalty based on a weighted average reference price of $70.83 per tonne. As a result, the Company's effective royalty rate was 18.4% or $4.82 per tonne based on the average realized selling price of $26.26 per tonne in the second quarter of 2013.

Cost of sales was $20.1 million in the second quarter of 2014 compared to $17.5 million in the second quarter of 2013. Cost of sales comprises operating expenses, share-based compensation expense, equipment depreciation, depletion of mineral properties, coal stockpile inventory impairments and idled mine asset costs. Operating expenses in cost of sales reflect the total cash costs of product sold (a non-IFRS financial measure, see section 3 for further analysis) during the period.

	Three months ended June 30,		Six months ended June 30,	
$ in thousands	**2014**	**2013**	**2014**	**2013**
Operating expenses	**$ 6,754**	$ 5,988	**$ 12,317**	$ 9,209
Share-based compensation expense	**127**	(153)	**143**	(153)
Depreciation and depletion	**2,061**	2,037	**4,540**	2,587
Impairment of coal stockpile inventories	**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	**4,898**	5,755	**7,925**	22,169
Cost of sales	**$ 20,086**	$ 17,477	**$ 38,452**	$ 38,783

Operating expenses in cost of sales were $6.8 million in the second quarter of 2014 compared to $6.0 million in the second quarter of 2013. Total cash costs of product sold were $10.72 per tonne in the second quarter of 2014 compared to $18.63 per tonne in the second quarter of 2013. The decrease in total cash costs per tonne sold primarily relates to an increase in tonnage sold as the Company focused on pit preparation in the second quarter of 2013.

Cost of sales in the second quarter of 2014 and the second quarter of 2013 included coal stockpile impairments of $6.2 million and $3.9 million, respectively, to reduce the carrying value of the Company's coal stockpiles to their net realizable value. The coal stockpile impairments recorded in both 2014 and 2013 reflect the challenging coal market conditions and primarily related to the Company's higher-ash products.

Cost of sales related to idled mine asset costs primarily consisted of period costs, which were expensed as incurred and primarily included depreciation expense. Cost of sales related to idled mine assets in the second quarter of 2014 included $4.9 million related to depreciation expenses for idled equipment (2013: $5.8 million). Idled mine asset costs decreased in the second quarter of 2014 compared to the second quarter of 2013 as a result of the recommencement of mining operations at the Ovoot Tolgoi Mine on March 22, 2013. However, the second quarter 2014 production plan did not fully utilize the Company's existing mining fleet, therefore, idled mine asset costs continued to be incurred throughout the second quarter of 2014.

Other operating expenses were $1.8 million in the second quarter of 2014 compared to $14.9 million in the second quarter of 2013.

$ in thousands	Three months ended June 30, 2014	Three months ended June 30, 2013	Six months ended June 30, 2014	Six months ended June 30, 2013
Foreign exchange loss/(gain)	**$ (146)**	$ 26	**$ (910)**	$ 391
Impairment loss on available-for-sale financial asset	**-**	3,067	**1,766**	3,067
Impairment loss on prepaid expenses and deposits	**3,405**	-	**3,405**	-
Impairment loss on property, plant and equipment	**277**	4,299	**277**	4,299
Impairment loss on materials and supplies inventories	**-**	6,930	**-**	6,930
Proceeds on disposal of mining license	**(1,818)**	-	**(1,818)**	-
Other	**58**	603	**129**	668
Other operating expenses	**$ 1,776**	$ 14,925	**$ 2,849**	$ 15,355

The Company's investment in Aspire is accounted for as an available-for-sale financial asset and carried at its fair value. In the second quarter of 2014, Aspire's market capitalization increased with the gain for the Company being recorded in other comprehensive income. This compares to an impairment loss of $3.1 million recognized in other operating expenses in the second quarter of 2013 as a result of a decrease in Aspire's market capitalization during that period.

The Company recognized an impairment loss of $3.4 million in the second quarter of 2014 related to prepaid toll washing fees under the contract with Ejinaqi Jinda Coal Industry Co. Ltd. ("Ejin Jinda"). The impairment charge is a result of the continued delay in starting the commercial operations at the wet washing facility and the continued soft coal market in China. In the second quarter of 2014 the Company recognized an impairment charge of $0.3 million in respect of surplus construction materials. In the second quarter of 2013, the Company recognized a total of $11.2 million in impairment in respect of material and supplies ($6.9 million) and property, plant and equipment ($4.3 million).

In the second quarter of 2014, the Company completed the sale of the Tsagaan Tolgoi mining license. The gross proceeds of the sale were $2.0 million, indirect taxes and costs totaled $0.2 million and a withholding tax totaling $0.5 million was incurred. The net proceeds generated for the Company after taxes and costs were $1.3 million.

Administration expenses were $2.3 million in the second quarter of 2014 compared to $4.0 million in the second quarter of 2013.

$ in thousands	Three months ended June 30, 2014	Three months ended June 30, 2013	Six months ended June 30, 2014	Six months ended June 30, 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	**94**	126	**225**	274
Depreciation	**32**	34	**64**	121
Administration expenses	**$ 2,253**	$ 4,024	**$ 4,490**	$ 7,757

Administration expenses were lower in the second quarter of 2014 compared to the second quarter of 2013 primarily due to lower professional fees. Professional fees in the second quarter of 2013 included $1.6 million of fees related to the internal investigations led by a tripartite committee referred to in section 6 "Regulatory Issues and Contingencies". The tripartite committee substantially completed the investigative phase of its activities during 2013, therefore additional professional fees were not incurred in the second quarter of 2014.

Corporate administration costs were also lower in the second quarter of 2014 compared to the second quarter of 2013 as a result of the Company's cost-cutting initiatives.

Evaluation and exploration expenses were $0.1 million in the second quarter of 2014 compared to $0.2 million in the second quarter of 2013. The Company continued to minimize evaluation and exploration expenditures in the second quarter of 2014 in order to preserve the Company's financial resources. Evaluation and exploration activities and expenditures in the second quarter of 2014 were limited to ensuring that the Company met the Mongolian Minerals Law requirements in respect of its mining and exploration licenses.

Finance costs were $5.2 million and $5.6 million in the second quarter of 2014 and 2013 which primarily consisted of interest expense on the $250.0 million CIC convertible debenture.

Finance income was $0.1 million in the second quarter of 2014 compared to $3.4 million in the second quarter of 2013 primarily consisting of unrealized gains on the fair value change of the embedded derivatives in the CIC convertible debenture ($0.1 million and $3.3 million respectively for the second quarter of 2014 and second quarter of 2013). The fair value of the embedded derivatives in the CIC convertible debenture is driven by many factors including: the Company's common share price, U.S. Dollar and Canadian Dollar exchange rates and share price volatility.

Income tax expense was $0.5 million in the second quarter of 2014 compared to an expense of $0.4 million in the second quarter of 2013. The $0.5 million recognized in the second quarter of 2014 relates to taxes paid in respect of the sale of the Tsagaan Tolgoi mining license.

<u>For the six months ended June 30, 2014</u>

The Company recorded a $34.2 million loss from operations in the first six months of 2014 compared to a $51.9 million loss from operations in the first six months of 2013. The first six months of 2014 were impacted by continuing difficult market conditions which resulted in lower sales prices compared to the first six months of 2013. This reduction in prices was offset by higher sales volumes, lower royalty expenses, lower idled mine asset costs and lower impairment losses in the first six months of 2014 compared to the first six months of 2013.

Revenue was $11.8 million in the first six months of 2014 compared to $10.5 million in the first six months of 2013. The Company sold 1.02 million tonnes of coal at an average realized selling price of $15.22 per tonne in the first six months of 2014 compared to sales of 0.60 million tonnes at an average realized selling price of $24.7 per tonne in the first six months of 2013. The average realized selling price was impacted by the product mix in the first six months of 2014. The first six months of 2014 product mix primarily consisted of thermal coal with limited Standard semi-soft coking coal compared to a mix of Premium semi-soft coking coal and thermal coal in the first six months of 2013.

The Company's revenue is presented net of royalties and selling fees. With the changes affecting the royalty regime in Mongolia, the Company's effective royalty rate for the first six months of 2014, based on the Company's average realized selling price of $15.22 per tonne, was 16.2% or $2.46 per tonne compared to 13.0% or $3.21 per tonne based on the average realized selling price of $24.70 per tonne in the first six months of 2013.

Cost of sales was $38.5 million in the first six months of 2014 compared to $38.8 million in the first six months of 2013. Cost of sales comprises operating expenses, share-based compensation expense, equipment depreciation, depletion of mineral properties, coal stockpile inventory impairments and idled mine asset costs. Operating expenses in cost of sales reflect the total cash costs of product sold (a non-IFRS financial measure, see section 3 for further analysis) during the period.

Operating expenses in cost of sales were $12.3 million in the first six months of 2014 compared to $9.2 million in the first six months of 2013. Total cash costs of product sold were $12.08 per tonne in the first six months of 2014 compared to $15.43 per tonne in the first six months of 2013. The decrease in total cash costs per tonne sold primarily relates to an increase in tonnage sold as the Company focused on pit preparation in the second quarter of 2013.

Cost of sales in the first six months of 2014 and the first six months of 2013 included coal stockpile impairments of $13.5 million and $5.0 million, respectively, to reduce the carrying value of the Company's coal stockpiles to their net realizable value. The coal stockpile impairments recorded in both 2014 and 2013 reflect the challenging coal market conditions and primarily related to the Company's higher-ash products.

Cost of sales related to idled mine asset costs primarily consisted of period costs, which were expensed as incurred and primarily included depreciation expense. Cost of sales related to idled mine assets in the first six months of 2014 included $7.9 million related to depreciation expenses for idled equipment (2013: $22.2 million). Idled mine asset costs decreased in the first six months of 2014 compared to the first six months of 2013 as a result of the period of curtailment from January 1, 2013 until March 22, 2013 when mining operations recommenced. However, the first six months of 2014 production plan did not fully utilize the Company's existing mining fleet, therefore, idled mine asset costs continued to be incurred throughout the first six months of 2014.

Other operating expenses were $2.8 million in the first six months of 2014 compared to $15.4 million in the first six months of 2013.

The Company's investment in Aspire is accounted for as an available-for-sale financial asset and carried at its fair value. In the first six months of 2014, Aspire's market capitalization fluctuated, in the first quarter of 2014 the market capitalization decreased and an impairment charge of $1.8 million was initially recorded. In the second quarter of 2014 the gain of $0.4 million was recorded in other comprehensive income. This compares to an impairment loss of $3.1 million recognized in other operating expenses in the first six months of 2013 as a result of a decrease in Aspire's market capitalization during that period.

The Company recognized an impairment loss of $3.4 million in the first six months of 2014 related to prepaid toll washing fees under the Ejin Jinda contract. The impairment charge is a result of the continued delay in starting the commercial operations at the wet washing facility and the continued soft coal market in China. In the first six months of 2014 the Company recognized an impairment charge of $0.3 million in respect of surplus construction materials. In the first six months of 2013, the Company recognized a total of $11.2 million in impairment in respect of material and supplies ($6.9 million) and property, plant and equipment ($4.3 million).

In the first six months of 2014 the Company completed sale of the Tsagaan Tolgoi mining license. The gross proceeds of the sale were $2.0 million, indirect taxes and costs totaled $0.2 million and a withholding tax totaling $0.5 million was incurred. The net proceeds generated for the Company after taxes and costs were $1.3 million.

Administration expenses were $4.5 million in the first six months of 2014 compared to $7.8 million in the first six months of 2013.

Administration expenses were lower in the first six months of 2014 compared to the first six months of 2013 primarily due to lower professional fees. Professional fees in the first six months of 2013 included $2.4 million of fees related to the internal investigations led by a tripartite committee referred to in section 6 "Regulatory Issues and Contingencies". The tripartite committee substantially completed the

investigative phase of its activities during 2013, therefore additional professional fees were not incurred in the second quarter of 2014.
Corporate administration costs were also lower in the first six months of 2014 compared to the first six months of 2013 reflecting the Company’s cost-cutting initiatives.

Evaluation and exploration expenses were $0.3 million in the first six months of 2014 compared to $0.5 million in the first six months of 2013. The Company continued to minimize evaluation and exploration expenditures in the first six months of 2014 in order to preserve the Company’s financial resources. Evaluation and exploration activities and expenditures in the first six months of 2014 were limited to ensuring that the Company met the Mongolian Minerals Law requirements in respect of its mining and exploration licenses.

Finance costs were $10.2 million and $10.6 million in the first six months of 2014 and 2013 respectively which primarily consisted of interest expense on the $250.0 million CIC convertible debenture.

Finance income was $1.1 million in the first six months of 2014 compared to $4.1 million in the first six months of 2013 primarily consisting of unrealized gains on the fair value change of the embedded derivatives in the CIC convertible debenture ($1.1 million and $4.1 million respectively for the first six months of 2014 and the first six months of 2013). The fair value of the embedded derivatives in the CIC convertible debenture is driven by many factors including: the Company’s common share price, U.S. Dollar and Canadian Dollar exchange rates and share price volatility.

Income tax expense was $0.5 million in the first six months of 2014 compared to an expense of $1.5 million in the first six months of 2013. The $0.5 million recognized in the first six months of 2014 relates to taxes paid in respect of the sale of the Tsagaan Tolgoi mining license.

Summary of Quarterly Operational Data

	2014		2013				2012	
Quarter Ended	**30-Jun**	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec	30-Sep
Sales Volumes, Prices and Costs								
Premium semi-soft coking coal								
Coal sales *(millions of tonnes)*	**-**	-	0.21	0.04	0.21	0.08	0.03	-
Average realized selling price *(per tonne)* [i]	**$ -**	$ -	$ 37.54	$ 37.50	$ 32.46	$ 45.81	$ 47.86	$ -
Standard semi-soft coking coal								
Coal sales *(millions of tonnes)*	**0.12**	0.29	1.40	0.87	-	-	-	0.01
Average realized selling price *(per tonne)* [i]	**$ 20.33**	$ 22.00	$ 24.49	$ 21.67	$ -	$ -	$ -	$ 49.91
Thermal coal								
Coal sales *(millions of tonnes)*	**0.51**	0.10	0.11	0.03	0.11	0.20	-	0.31
Average realized selling price *(per tonne)* [i]	**$ 10.72**	$ 12.07	$ 12.60	$ 13.07	$ 13.98	$ 13.67	$ -	$ 15.87
Total								
Coal sales *(millions of tonnes)*	**0.63**	0.39	1.72	0.94	0.32	0.28	0.03	0.32
Average realized selling price *(per tonne)* [i]	**$ 12.52**	$ 19.54	$ 25.30	$ 22.05	$ 26.26	$ 22.75	$ 47.86	$ 16.98
Raw coal production *(millions of tonnes)*	**0.55**	0.64	1.73	1.13	0.17	0.02	-	-
Direct cash costs of product sold *(per tonne)* [ii]	**$ 8.23**	$ 10.43	$ 11.13	$ 9.41	$ 11.49	$ 10.22	$ 11.67	$ 9.56
Mine administration cash costs of product sold *(per tonne)* [ii]	**$ 2.49**	$ 3.80	$ 1.39	$ 2.20	$ 7.14	$ 1.46	$ 5.08	$ 3.75
Total cash costs of product sold (*per tonne)* [ii]	**$ 10.72**	$ 14.23	$ 12.52	$ 11.61	$ 18.63	$ 11.68	$ 16.75	$ 13.31
Other Operational Data								
Production waste material moved *(millions of bank cubic meters)*	**2.17**	2.55	3.77	1.57	2.71	0.40	-	-
Strip ratio *(bank cubic meters of waste material per tonne of coal produced)*	**3.97**	4.02	2.18	1.39	15.55	26.21	-	-
Lost time injury frequency rate [iii]	**0.15**	-	-	-	-	-	0.1	0.2

(i) Average realized selling price excludes royalties and selling fees.
(ii) A non-IFRS financial measure, see section 3. Cash costs of product sold exclude idled mine asset cash costs.
(iii) Per 200,000 man hours and calculated based on a rolling 12 month average.

Summary of Quarterly Financial Results

$ in thousands, except per share information	2014		2013				2012	
Quarter Ended	**30-Jun**	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec	30-Sep
Financial Results								
Revenue (i), (ii)	**$ 6,691**	$ 5,137	$ 32,457	$ 15,652	$ 6,129	$ 4,398	$ 1,186	$ 3,804
Cost of sales (ii)	**(20,086)**	(18,366)	(40,359)	(33,486)	(17,477)	(21,305)	(32,229)	(31,454)
Gross profit/(loss) excluding idled mine asset costs	**(8,497)**	(10,202)	(4,141)	(13,323)	(5,593)	(494)	(12,601)	(8,719)
Gross profit/(loss) including idled mine asset costs	**(13,395)**	(13,229)	(7,900)	(17,834)	(11,348)	(16,907)	(31,043)	(27,650)
Other operating expenses	**(1,776)**	(1,073)	(109,682)	(1,003)	(14,925)	(431)	(19,282)	(18,315)
Administration expenses	**(2,253)**	(2,237)	(3,668)	(4,204)	(4,024)	(3,733)	(6,080)	(5,178)
Evaluation and exploration expenses	**(107)**	(172)	(489)	(186)	(221)	(273)	(508)	(958)
Loss from operations	**(17,531)**	(16,711)	(121,740)	(23,227)	(30,518)	(21,344)	(56,913)	(52,101)
Finance costs	**(5,215)**	(5,025)	(5,167)	(5,382)	(5,617)	(4,996)	(4,718)	(5,164)
Finance income	**127**	1,007	1,301	124	3,366	775	(116)	12,947
Share of earnings/(losses) of joint venture	**(3)**	(26)	(15)	(66)	44	(17)	144	288
Income tax recovery/(expense)	**(546)**	-	(13,109)	(13,377)	(416)	1,916	5,040	(2,383)
Net loss	**(23,168)**	(20,755)	(138,730)	(41,928)	(33,141)	(23,666)	(56,564)	(46,413)
Basic loss per share	**$ (0.12)**	$ (0.11)	$ (0.75)	$ (0.23)	$ (0.18)	$ (0.13)	$ (0.31)	$ (0.26)
Diluted loss per share	**$ (0.12)**	$ (0.11)	$ (0.75)	$ (0.23)	$ (0.18)	$ (0.13)	$ (0.31)	$ (0.26)

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

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

3. NON-IFRS FINANCIAL MEASURES

The Company has included the non-IFRS financial measure "cash costs" in this MD&A to supplement its condensed consolidated interim financial statements, which have been prepared in accordance with IFRS.

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

Cash Costs

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

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

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

	Three months ended June 30,		Six months ended June 30,	
$ in thousands, except per tonne information	**2014**	**2013**	**2014**	**2013**
Cash costs				
Cost of sales determined in accordance with IFRS	**$ 20,086**	$ 17,477	**$ 38,452**	$ 38,783
Less non-cash expenses	**(8,434)**	(5,734)	**(18,210)**	(7,398)
Less non-cash idled mine asset costs	**(4,860)**	(5,716)	**(7,850)**	(16,873)
Total cash costs	**6,792**	6,027	**12,392**	14,512
Less idled mine asset cash costs	**(37)**	(38)	**(75)**	(5,297)
Total cash costs excluding idled mine asset cash costs	**6,755**	5,989	**12,317**	9,215
Coal sales *(millions of tonnes)*	**0.63**	0.32	**1.02**	0.60
Total cash costs of product sold *(per tonne)*	**$ 10.72**	$ 18.63	**$ 12.08**	$ 15.43

	Three months ended June 30,		Six months ended June 30,	
$ in thousands, except per tonne information	**2014**	**2013**	**2014**	**2013**
Cash costs				
Direct cash costs of product sold *(per tonne)*	**$ 8.23**	$ 11.49	**$ 9.08**	$ 10.90
Mine administration cash costs of product sold *(per tonne)*	**2.49**	7.14	**3.00**	4.53
Total cash costs of product sold *(per tonne)*	**$ 10.72**	$ 18.63	**$ 12.08**	$ 15.43

4. PROPERTIES

The Company currently holds two mining licenses and four exploration licenses in Mongolia, which in total cover an area of approximately 223,000 hectares ("ha"). The mining licenses pertain to the Ovoot Tolgoi Complex (12726A) and the Soumber Deposit (MV-016869).

In addition to the existing mining licenses, the Company also holds two exploration licenses (9443X and 9449X) pertaining to certain areas associated with the Soumber Deposit for which pre-mining agreements ("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.

Operating Mines

Ovoot Tolgoi Mine

The Ovoot Tolgoi Mine is located in the southwest corner of the Umnugobi Aimag (South Gobi Province) of Mongolia. The deposit is within the administrative unit of Gurvantes Soum, 320km southwest of the provincial capital of Dalanzadgad and 950km southwest of the nation's capital of Ulaanbaatar. Mining operations at the Ovoot Tolgoi Mine have been carried out in two distinct areas, the Sunset Pit to the west and the Sunrise Pit to the east.

Saleable products from the Ovoot Tolgoi Mine primarily include the Standard and Premium semi-soft coking coal products. The Company's raw semi-soft products together with raw higher-ash coals are suitable for washing and blending in order to be sold as a 1/3 coking coal in the Chinese market. Some higher-ash product is sold as a thermal coal product as and when the market allows. The Company intends to continue to develop markets for both its Premium and Standard semi-soft coking coal brands and to pursue long-term supply offtake with end users in China to complement its existing customer base and to gain best value of the Company's coal in the Chinese market. The Company is committed to further enhance the quality of its coal products through wet washing and increase its market penetration in China, and as part of this strategy is cooperating with Ejin Jinda to study the utilization of the Ejin Jinda wet washing facility (refer to "Processing Infrastructure – Wet Washing Facility" section below).

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 Measured and Indicated Mineral Resources are inclusive of those Mineral Resources modified to produce the 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 24, 2014, 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.

Operational Data and Financial Results

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

Processing Infrastructure

Dry Coal Processing

Following an extensive review that commenced in the fourth quarter of 2013, the Company concluded in the first quarter of 2014 that it does not plan to either complete or use the dry coal handling facility ("DCHF") at the Ovoot Tolgoi Mine in the foreseeable future. As a result of the review and subsequent impairment assessment, the Company recorded a $66.9 million non-cash impairment in the fourth quarter of 2013 to reduce the carrying value of the DCHF to its recoverable amount. The DCHF had a carrying value of $11.2 million at June 30, 2014. The Company continues to use mobile screens for initial dry processing of its higher-ash coals. The use of mobile screens at stockpile areas closer to the pits has enabled the Company to realize a cost benefit compared to hauling the coal to the central DCHF and operating the rotary breaker. This provides a lower cost solution without adversely impacting the coal quality of the coal planned to be mined over the next year.

As coal markets improve and production from the Ovoot Tolgoi Mine increases in line with its anticipated annual capacity of 9 million tonnes run-of-mine production, the Company will review the use of the DCHF as part of its existing assets and continue developing beneficiation capabilities to maximize value from its product.

Wet Washing Facility

In 2011, the Company entered into an agreement with Ejin Jinda, a subsidiary of China Mongolia Coal Co. Ltd. to toll-wash coals from the Ovoot Tolgoi Mine. The agreement has a duration of five years from commencement of the contract and provides for an annual wet washing capacity of approximately 3.5 million tonnes of input coal. The facility is located approximately 10km inside China from the Shivee Khuren Border Crossing, approximately 50km from the Ovoot Tolgoi Mine. Ejin Jinda will charge the Company a single toll washing fee which will cover their expenses, capital recovery and profit. Ejin Jinda will also transport coal from the Ovoot Tolgoi Mine to the wet washing facility under a separate transportation agreement.

To date, commercial operations at the 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 (refer to Section 5 "Liquidity and Capital Resources – Contractual Obligations and Guarantees" section below), a $30.2 million impairment loss on the $33.6 million 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 $3.4 million 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. Subject to financing availability for the Company, further trial samples are required to be performed ahead of the wet washing facility being ready for commercial operation.

The Company's objective continues to be the implementation of an effective and profitable wet washing solution, and the Company is cooperating with Ejin Jinda in reviewing the utilization of the wet washing facility.

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 LLC"). SouthGobi Sands LLC holds a 40% interest in RDCC LLC.

On October 26, 2011, RDCC LLC signed a concession agreement with the State Property Committee of Mongolia. RDCC LLC has the right to conclude a 17 year build, operate and transfer agreement under the Mongolian Law on Concessions. Construction of the paved highway was substantially complete by the end of 2013. The 2014 construction program commenced in the second quarter of 2014. Subject to the Company having available financial resources to fund its portion of the remaining construction costs, the remaining construction work and commissioning of the paved highway is expected to be completed by the end of 2014. On July 24, 2014 the Ministry of Economic Development of Mongolia confirmed that RDCC LLC's request to postpone the July 2014 deadline for commissioning of the paved highway until December 30, 2014 had been approved.

The paved highway will have an intended carrying capacity upon completion in excess of 20 million tonnes of coal 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. The first half 2014 production plan did not fully utilize the Company's existing mining fleet.

Workforce

As at June 30, 2014, SouthGobi Sands LLC employed 390 employees in Mongolia. Of the 390 employees, 59 are employed in the Ulaanbaatar office, 2 in outlying offices and 329 at the Ovoot Tolgoi Mine site. Of the 390 employees based in Mongolia, 383 (98%) are Mongolian nationals and of those, 173 (45%) are residents of the local Gurvantes, Dalanzadgad, Sevrei and Noyon Soums.

Development Projects and Exploration Program

Soumber Deposit

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

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

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

On March 25, 2013, the Company reported an updated NI 43-101 compliant independent resource estimate prepared by RPM. RPM estimated that the Soumber Deposit contains measured coal resources of 62.4 million tonnes, indicated coal resources of 110.3 million tonnes and inferred coal resources of 123.0 million tonnes as at January 10, 2013. Approximately 76% of the Soumber Deposit resource is located above 300m and is amenable to surface mining. Details of the assumptions and parameters used to calculate the resources and coal quality estimates and information on data verification are set out in the Annual Information Form dated March 24, 2014, 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.

On July 6, 2011, the Company announced that the Mineral Resources Authority of Mongolia ("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.

Environmental baseline studies have been completed and general environmental impact assessments have been approved. The Company has delayed plans for a pre-feasibility study for the Soumber Deposit and intends to manage the feasibility planning and physical preparation of the Soumber Deposit with respect to ongoing market conditions, government requirements and the Company's available financial resources. The Company has engaged the relevant authorities in Mongolia concerning these planned delays.

Zag Suuj Deposit

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

Based on the exploration results to date, the coal occurrence at the Zag Suuj Deposit can be divided into four major seam groups. Each of the seam groups split into a number of coal plies of highly variable thickness, separated by stone partings. Interburden between the seams is mainly sandstone and conglomerate, whilst partings within the seams tend to be dominated by mudstone and carbonaceous mudstone. Correlation of the coal seams at the Zag Suuj Deposit with the Ovoot Tolgoi 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. 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 24, 2014, 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.

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 2014. Exploration activities in 2014 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 24, 2014, and available at www.sedar.com.

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.

Aspire (18.8% owned)

As at June 30, 2014, the Company owned 18.8% of 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. On July 31, 2013, Aspire announced an upgraded Australian JORC code 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. Reported coal resources are inclusive of coal reserves[2].

On June 13, 2014, Aspire announced that it entered into a binding agreement to acquire the Xanadu Mines Limited 50% interest in the Ekhgoviin Chuluu Joint Venture ("ECJV") with the Noble Group retaining its 50% ownership. The ECJV currently has a 60% interest in the Nuurstei Coking Coal Project in Northern Mongolia.

As at August 11, 2014, SouthGobi had invested a total of $27.9 million in Aspire and its interest in Aspire has a market value of $4.9 million.

Exploration Program

The Company continued to minimize evaluation and exploration expenditures in the second quarter of 2014 in order to preserve the Company's financial resources. The 2014 exploration program will be focused on further defining the Soumber Deposit. Other exploration activities and expenditures will be limited to ensuring that the Company meets the Mongolian Minerals Law requirements in respect of its mining and exploration licenses including those related to the Soumber Deposit.

5. LIQUIDITY AND CAPITAL RESOURCES

Liquidity and Capital Management

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

On May 25, 2014, the Company announced it had obtained a $10 million 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 $0.1 million;
- 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.

[2] For more information on the Aspire resource and reserve estimates, refer to Aspire's press release dated July 31, 2013 and available at www.aspiremininglimited.com.

As at June 30, 2014 the Company had drawn down $3.8 million under this facility. Notwithstanding the provision of the $10 million shareholder loan facility, the Company continues to experience negative impacts on its margins and liquidity and there can be no assurance that the Company will have sufficient funding for the balance of 2014 to be able to continue as a going concern.

The Company anticipates that coal prices in China will remain under pressure through the end of 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. Refer to section 11 "Risk Factors". Therefore, the Company is actively seeking additional sources of financing to continue operating and meet its objectives.

Several adverse conditions and material uncertainties cast significant doubt upon the going concern assumption. The Company had cash of $8.8 million and working capital (excess current assets over current liabilities) of $16.7 million at June 30, 2014. 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. Refer to section 11 "Risk Factors". 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 under the $250.0 million 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.

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

As at June 30, 2014, the Company had cash of $8.8 million compared to cash of $21.8 million as at December 31, 2013. Working capital (excess current assets over current liabilities) was $16.7 million as at June 30, 2014 compared to $41.7 million as at December 31, 2013. As at August 11, 2014, the Company had cash of $6.2 million and there have been no further amounts drawn down under the Turquoise Hills Loan Facility since June 30, 2014.

As at June 30, 2014, the Company's gearing ratio was 0.20 (December 31, 2013: 0.19), which was calculated based on the Company's long term liabilities to total assets. As at June 30, 2014, the Company is not subject to any externally imposed capital requirements.

CIC Convertible Debenture

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

On March 29, 2010, the Company exercised its right to call for the conversion of up to $250.0 million of the CIC convertible debenture into approximately 21.5 million shares at a conversion price of $11.64 (Cdn$11.88). As at June 30, 2014, the CIC owned, through its indirect wholly owned subsidiary, approximately 16% of the issued and outstanding common shares of the Company.

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.

Mongolian IAAC Investigation

In the first quarter of 2013, the Company was subject to orders imposed by Mongolia's Independent Authority against Corruption (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 Mongolian State Investigation Office (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.

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.

Cash Flow Highlights

	Six months ended June 30,	
$ in thousands	**2014**	**2013**
Cash used in operating activities	**$ (14,056)**	$ (7,193)
Cash generated from/(used in) investing activities	**(2,707)**	6,459
Cash generated from financing activities	**3,807**	81
Effect of foreign exchange rate changes on cash	**(92)**	150
Decrease in cash for the period	**(13,048)**	(503)
Cash balance, beginning of period	**21,837**	19,674
Cash balance, end of period	**$ 8,789**	$ 19,171

Cash used in Operating Activities

The Company used $14.1 million of cash in operating activities for the six months ended June 30, 2014 compared to $7.2 million for the six months ended June 30, 2013. This increase is primarily attributed to the movement in non-cash working capital. The Company increased its level of non-cash working capital by $0.1 million during the six months ended June 30, 2014 compared to releasing $10.4 million during the six months ended June 30, 2013. The Company's relatively stable non-cash working capital movement for the six months ended June 30, 2014 is achieved despite a significant reduction of trade and other payables by $13.3 million which was funded through increases in deferred revenue $13.0 million which represents cash received in advance of the recognition of revenue.

Cash generated from/(used in) Investing Activities

The Company used $2.7 million of cash in investing activities for the six months ended June 30, 2014 whereas $6.5 million was generated for the six months ended June 30, 2013. In the first half of 2013, cash generated from investing activities primarily related to the proceeds from maturing investments partially offset by deferred stripping activities; whereas in the first half of 2014, $4.1 million relates to property, plant and equipment additions including capitalized deferred stripping cost offset by net proceeds of $1.3 million from the sale of the Tsagaan Tolgoi mining license.

Cash generated from Financing Activities

The cash generated from financing activities in the six months ended June 30, 2014 primarily related to the revolving credit facility from Turquoise Hill. At June 30, 2014 the Company had drawn down $3.8 million under this facility.

Contractual Obligations and Guarantees

Day-to-day mining, expansionary and sustaining capital expenditures as well as administrative operations give rise to commitments for future minimum payments. As at June 30, 2014, the Company's operating and capital commitments were:

	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 $17.6 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.

Ovoot Tolgoi Mine Impairment Analysis

Unchanged from the assessment made as at December 31, 2013, and March 31, 2014 respectively, 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 second quarter of 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 $397.2 million 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.

Key sensitivities in the valuation model are as follows:

- for each 1% increase/(decrease) in the long term real selling price of semi-soft coking coal FOB Australia, the calculated value of the cash generating unit increases/(decreases) by approximately $24.1/($24.1) million; and
- for each 1% increase/ (decrease) in the pre-tax discount rate, the calculated value of the cash generating unit (decreases)/increases by approximately ($22.1)/$23.9 million.

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.

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") and Aspire are determined using this methodology. The Company's investment in the shares of Kangaroo and its money market investments are classified as fair value through profit or loss ("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.

	As at	
$ in thousands	**June 30, 2014**	**December 31, 2013**
Financial assets		
Loans-and-receivables		
Cash	**$ 8,789**	$ 21,837
Trade and other receivables	**896**	2,578
Available-for-sale		
Investment in Aspire	**4,309**	6,175
Fair value through profit or loss		
Investment in Kangaroo	**95**	222
Total financial assets	**$ 14,089**	$ 30,812

	As at	
$ in thousands	**June 30, 2014**	**December 31, 2013**
Financial liabilities		
Fair value through profit or loss		
Convertible debenture - embedded derivatives	**$ 2,274**	$ 3,395
Other-financial-liabilities		
Trade and other payables	**18,830**	31,241
Convertible debenture - debt host	**95,260**	93,208
Total financial liabilities	**$ 116,364**	$ 127,844

The net loss in the second quarter of 2014 and 2013 included the 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 June 30,		Six months ended June 30,	
$ in thousands	**2014**	**2013**	**2014**	**2013**
Unrealized loss on FVTPL investments	**$ 8**	$ 473	**$ 48**	$ 468
Unrealized gain on embedded derivatives in CIC convertible debenture	**121**	3,343	**1,120**	4,091

The Company recorded an unrealized gain of $0.4 million in other comprehensive income in the second quarter of 2014 related to the investment in Aspire compared to an impairment loss of $1.8 million in other operating expenses in the first quarter of 2014. The Company recorded an unrealized gain of $0.9 million in other comprehensive income in the first half of 2013 related to the investment in Aspire.

6. REGULATORY ISSUES AND CONTINGENCIES

Regulatory Issues

Governmental and Regulatory Investigations

The Company is subject to investigations by the IAAC and 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 Second District Court which 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.

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. It disputes 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 $1.5 million held in local bank accounts, in connection with its continuing investigation of these allegations. This $1.5 million 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.

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".

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 mining license 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.

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.

Other Corporate Information

Prior to the listing of the securities of the Company on the Hong Kong Stock Exchange ("HKEX") in 2010, the Company applied to Hong Kong's Securities and Futures Commission (the "SFC") for, and was granted, a ruling that the Company is not a public company in Hong Kong for the purposes of the Takeovers Code (the "2009 Ruling"). Consequently the Takeovers Code has not applied to the Company since the time of its Hong Kong listing.

In June 2014, the Company made an application to the SFC for a confirmation of the SFC's prior ruling that the Company is not a public company in Hong Kong for the purposes of the Takeovers Code. The Company made this application so it could assess, with a greater degree of certainty, its options for sourcing the additional financing it requires to continue operating and meet its obligations.

Following the application to the SFC, the Takeovers and Mergers Panel of the SFC ("Takeovers Panel") determined on June 19, 2014 that the Company should be considered a public company in Hong Kong for the purposes of the Takeovers Code. The Takeovers Code now applies to the Company.

The Takeovers Panel's decision was based primary upon the material change in the greater number of Hong Kong shareholders as reflected in the proportions of shares held on the Hong Kong and Canadian register, in particular the relative proportions held by the public (excluding Turquoise Hill and CIC). The Takeovers Panel was also of the view that there is a material change in relation to the extent of trading in the shares in Hong Kong as reflected in the proportionate trading volumes on the HKEX and in Canada. As a result, the Takeover Panel has concluded that the 2009 Ruling which considered that the Company should not be a public company in Hong Kong for the purposes of the Takeovers Code is no longer valid and the Company should be considered a public company in Hong Kong within the meaning of section 4.2 of the Introduction to the Takeovers Code.

Details of the Takeovers Panel's written decision dated June 24, 2014 and published on June 30, 2014 is available in the SFC's website at www.sfc.hk.

The Company has been and continues to be subject to Canadian provincial securities laws, including those governing takeovers, mergers and share repurchases. Certain transactions that would otherwise be exempt under Canadian law from the requirement to make a formal offer to all shareholders may now trigger mandatory offer obligations under the Takeovers Code.

Contingencies

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".

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.

7. 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 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.
- 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.

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

	Three months ended June 30,		Six months ended June 30,	
$ in thousands	**2014**	**2013**	**2014**	**2013**
Corporate administration	**$ 161**	$ 228	**$ 373**	$ 380
Salaries and benefits	**350**	295	**900**	482
Finance costs	**157**	-	**157**	-
Total related party expenses	**$ 668**	$ 523	**$ 1,430**	$ 862

	Three months ended June 30,		Six months ended June 30,	
$ in thousands	**2014**	**2013**	**2014**	**2013**
GMM	**$ -**	$ 5	**$ -**	$ 57
Turquoise Hill	**227**	62	**241**	99
Rio Tinto	**358**	276	**911**	389
Turquoise Hill Singapore	**83**	180	**278**	317
Total related party expenses	**$ 668**	$ 523	**$ 1,430**	$ 862

	Three months ended June 30,		Six months ended June 30,	
$ in thousands	**2014**	**2013**	**2014**	**2013**
Corporate administration	**$ 17**	$ -	**$ 17**	$ 7
Total related party recoveries	**$ 17**	$ -	**$ 17**	$ 7

	Three months ended June 30,		Six months ended June 30,	
$ in thousands	2014	2013	2014	2013
Turquoise Hill	$ 17	$ -	$ 17	$ -
Rio Tinto	-	-	-	7
Total related party recoveries	$ 17	$ -	$ 17	$ 7

As at June 30, 2014, the Company had accounts receivable of $nil (December 31, 2013: $0.1 million), accounts payable of $7.8 million (December 31, 2013: $1.4 million) and amounts classified as interest bearing loans and borrowings totaling $3.8 million as at June 30, 2014, (December 31, 2013 $nil) with related parties. Included in the $7.8 million accounts payable as at June 30, 2014 are $5.3 million of legal and professional fees payable to Rio Tinto in respect of the internal and tripartite committees referred to in section 6 "Regulatory Issues and Contingencies".

8. OUTSTANDING SHARE DATA

The Company is authorized to issue an unlimited number of common shares without par value and an unlimited number of preferred shares without par value. As at August 11, 2014, 187,317,018 common shares were issued and outstanding. There are also incentive share options outstanding to acquire 2.3 million unissued common shares with exercise prices ranging from Cdn$0.65 to Cdn$12.99. There are no preferred shares outstanding.

As at August 11, 2014, Turquoise Hill directly owned 104,807,155 common shares representing approximately 56% of the issued and outstanding common shares of the Company.

As announced on July 30, 2014, upon closing of the transaction on the sale of 56,102,000 shares between Turquoise Hill and NUR, the number of shares held by Turquoise Hill is expected to reduce to 48,705,155. The transfer represents a 29.95% stake in the Company leaving Turquoise Hill with an approximate stake in the Company of 26.00%.

9. INTERNAL CONTROLS OVER FINANCIAL REPORTING

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

10. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

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

A detailed summary of all of the Company's significant accounting policies is included in note 3 to the Company's consolidated financial statements for the year ended December 31, 2013. Please refer to note 3.22 of the Company's December 31, 2013 consolidated financial statements for information regarding the accounting judgments and estimates that have the most significant effect on the amounts recognized in the Company's consolidated financial statements. There have been no significant changes to the significant accounting judgments and estimates since December 31, 2013.

11. RISK FACTORS

There are certain risks involved in the Company's operations, some of which are beyond its control. Material risks and uncertainties affecting the Company, their potential impact and the Company's principal risk management strategies are, other than as described below, substantially unchanged from those disclosed in the Company's MD&A for the year ended December 31, 2013, which is available at www.sedar.com.

If the Company 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, the Company 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 and may be forced to seek relief under applicable legislation (or an involuntary petition for bankruptcy relief or similar creditor action may be filed or taken against it). Therefore, the Company is actively seeking additional sources of financing to continue operating and meet its objectives.

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 in order to pay the interest due under the CIC convertible debenture on November 19, 2014, and it must secure additional funding in order to address its cash requirements through June 30, 2015, to provide it with additional liquidity. The urgency of the Company's liquidity constraints may require the Company to pursue such a transaction on unfavourable terms. Moreover, the Company's ability to successfully implement, and the cost of, any such transaction will depend on numerous factors, including:

- demand and prices for its coal products;
- general economic conditions;
- strength of the credit and capital markets;
- its ability to successfully execute its operational strategies, and its operating and financial performance;
- its ability to remain in compliance with the CIC convertible debenture;
- its ability to maintain relationships with its suppliers, customers, employees, stockholders and other third parties; and
- market uncertainty in connection with its ability to continue as a going concern as well as investor confidence.

The Company is focused on addressing its liquidity and leverage issues. On May 25, 2014, the Company announced it has obtained the Turquoise Hill Loan Facility. The Turquoise Hill Loan Facility is subject to certain terms and conditions with respect to draw downs, mandatory prepayment and termination provisions. As a result, there is no assurance that any further drawn down would meet the requirements of the Turquoise Hill Loan Facility.

Notwithstanding the Turquoise Hill Loan Facility, the Company continues to experience negative impacts on its margins and liquidity and there can be no assurance that the Company will have sufficient funding for the balance of 2014 to be able to continue as a going concern, including the interest payment on the CIC convertible debenture, which is approximately $8 million due in November 2014. If the Company fails to secure additional funding, the failure to make such payment to CIC, if not cured within three business days, would result in an event of default under the CIC convertible debenture and CIC would have the right to declare the principal and accrued interest owing thereunder immediately due and payable. If the Company fails to pay such interest, or to restructure or refinance its current outstanding indebtedness, or to secure additional funding to address its cash requirements through June 30, 2015, it may not have adequate liquidity to fund its operations and meet its obligations (including debt payment obligations), it may not be able to continue as a going concern and may be forced to seek relief under applicable legislation (or an involuntary petition for bankruptcy relief or similar creditor action may be filed or taken against it).

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

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

In order to address the Company's liquidity constraints and in addition to its ongoing efforts to secure additional capital or otherwise pursue a strategic restructuring, refinancing or other transaction to provide it with additional liquidity, the Company has embarked on a cash management strategy to enhance and preserve as much liquidity as possible.

The Company cannot provide any assurance that it will be successful in accomplishing any of these plans or that any of these actions can be effected on a timely basis, on satisfactory terms or maintained once initiated. Furthermore, the Company's cash management strategy, if successful, may limit certain of its operational and strategic initiatives designed to grow its business over the long term.

The significant uncertainties faced by the Company relating to its ability to generate sufficient cash flows from operations and to continue to operate its business, may affect the price and volatility of the Company's common shares and any investment in such shares could suffer a significant decline or total loss in value. This volatility may adversely affect the price of the Company's common shares regardless of the Company's operating performance.

12. OUTLOOK

The Company continues to operate under difficult market conditions. Coal prices in China declined further in the second quarter compared to the first quarter of 2014 as a result of strong seaborne and Chinese domestic supply. The decline in coal prices has been partially offset by the increase in the Company's volumes in the second quarter compared to the seasonally slow first quarter.

In June 2014, following a review of operations in response to current market conditions, the Company reduced its production and placed approximately half of its workforce in furlough. This furlough is anticipated to remain in place until the end of August subject to market conditions. Contracted sales volumes are expected to be met from the combination of the existing coal stockpile and reduced production volumes.

The Company anticipates that coal prices in China will remain under pressure through the end of 2014, which will continue to impact the Company's margins and liquidity. The Company continues to strive for further cost reductions and where possible delay expenditures. As at the date hereof, the Company expects to be able to make the $8 million cash interest payment on the CIC convertible debenture on November 19, 2014. However, in the event a loan or other financing arrangement is not secured by November 19, 2014, and even if such loan is secured, if the Company does not secure additional funding to address its cash requirements through June 30, 2015, the Company is unlikely to have sufficient capital resources and does not expect to generate sufficient cash flows from mining operations in order to satisfy its ongoing obligations and future contractual commitments. Therefore, the Company is actively seeking additional sources of financing to continue operating and meet its objectives.

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 as described above, it will not have adequate liquidity to fund its operations and meet its obligations (including its debt payment obligations) and it may not be able to continue as a going concern. See section 5 "Liquidity and Capital Resources" and section 11 "Risk Factors". 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 $250.0 million 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.

Longer term and assuming the Company's immediate liquidity challenges are resolved, the Company remains well positioned, with a number of key competitive strengths, including:

- **Strategic location** – The Ovoot Tolgoi Mine is located approximately 40km from China, which represents the main coal market. The Company has an infrastructure advantage, being approximately 50km from a major Chinese coal distribution terminal with rail connections to key coal markets in China.

- **Large resource base** – The Company's aggregate coal resources (including reserves) include measured and indicated resources of 497 million tonnes and inferred resources of 293 million tonnes.

- **Several growth options** – The Company has several growth options including an anticipated increase to 9 million tonnes annual run-of-mine capacity at the Ovoot Tolgoi Mine as well as greenfield options with the Soumber Deposit and Zag Suuj Deposit, located approximately 20km east and approximately 150km east of the Ovoot Tolgoi Mine, respectively.

- **Flexible product offering** – Most of the Company's coal resources have coking properties, including a mixture of semi-soft coking coals and hard coking coals. The Company is currently studying options to supply washed coal to the market to further improve its market position and access to end customers.

Objectives

The Company's objectives for 2014 and the medium term are as follows.

- Secure additional and immediate sources of financing – The Company is focused on securing additional and immediate sources of financing and continues to minimize uncommitted capital expenditures while preserving the Company's growth options.

- Drive operational excellence – The Company is focused on further improving operational efficiency in delivering production to meet market requirements and to further reduce operating and administrative costs.

- Continue to develop regional infrastructure – Subject to the Company having available financial resources to fund its portion of the construction costs, the Company's priority is 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. Construction of the paved highway was substantially complete by the end of 2013 with the remaining construction work and commissioning expected to be completed by the end of 2014.

- Deliver value through marketing by improving the Company's access to market and end customers and the overall quality of its product – Subject to available financial resources, implement an effective business structure and beneficiation process based on wet washing that is capable of delivering a sustainable and profitable product mix to the Chinese market and expand the Company's customer base further inland in China.

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

- Operating in a socially responsible manner – The Company is focused on maintaining its vigilance on health, safety and environmental performance.

- Re-establish the Company's reputation – The Company's vision is to be a respected and profitable Mongolian coal company. To achieve this, the Company will continue to work on re-establishing good working relationships with all external stakeholders.

August 11, 2014