SouthGobi Resources Ltd.
Condensed Consolidated Interim Financial Statements

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

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SouthGobi Resources Ltd.

Condensed Consolidated Interim Statements of Comprehensive Income

(Unaudited)

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

	Notes	Three months ended September 30, 2014	Three months ended September 30, 2013	Nine months ended September 30, 2014	Nine months ended September 30, 2013
Revenue		**$ 7,611**	$ 15,652	**$ 19,440**	$ 26,179
Cost of sales	4	**(23,922)**	(33,486)	**(62,375)**	(72,268)
Gross loss		**(16,311)**	(17,834)	**(42,935)**	(46,089)
Other operating expenses	5	**(2)**	(1,003)	**(2,851)**	(16,358)
Administration expenses	6	**(2,530)**	(4,204)	**(7,020)**	(11,958)
Evaluation and exploration expenses	7	**(122)**	(186)	**(401)**	(680)
Loss from operations		**(18,965)**	(23,227)	**(53,207)**	(75,085)
Finance costs	8	**(5,257)**	(5,382)	**(15,500)**	(15,991)
Finance income	8	**135**	124	**1,268**	4,259
Share of losses of joint venture	12	**(32)**	(66)	**(60)**	(39)
Loss before tax		**(24,119)**	(28,551)	**(67,499)**	(86,856)
Current income tax expense		**-**	-	**(546)**	(1)
Deferred income tax expense		**-**	(13,377)	**-**	(11,876)
Net loss attributable to equity holders of the Company		**(24,119)**	(41,928)	**(68,045)**	(98,733)
Other comprehensive income/(loss) to be reclassified to profit or loss in subsequent periods					
Change in value of available-for-sale financial asset, net of tax		**1,087**	1,261	**987**	1,261
Net comprehensive loss attributable to equity holders of the Company		**$ (23,032)**	$ (40,667)	**$ (67,058)**	$ (97,472)
Basic loss per share	9	**$ (0.13)**	$ (0.23)	**$ (0.36)**	$ (0.54)
Diluted loss per share	9	**$ (0.13)**	$ (0.23)	**$ (0.36)**	$ (0.54)

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

SouthGobi Resources Ltd.

Condensed Consolidated Interim Statements of Financial Position

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

	Notes	As at September 30, 2014	As at December 31, 2013
Assets			
Current assets			
Cash and cash equivalents		**$ 4,768**	$ 21,837
Trade and other receivables	10	**724**	2,578
Inventories	11	**35,215**	40,288
Prepaid expenses and deposits		**4,305**	11,506
Total current assets		**45,012**	76,209
Non-current assets			
Property, plant and equipment	13	**372,138**	399,395
Long term investments	12	**31,953**	30,602
Total non-current assets		**404,091**	429,997
Total assets		**$ 449,103**	$ 506,206
Equity and liabilities			
Current liabilities			
Trade and other payables	14	**$ 17,503**	$ 31,241
Deferred revenue		**13,649**	997
Interest-bearing borrowings	16	**3,835**	-
Current portion of convertible debenture	15	**9,326**	2,301
Total current liabilities		**44,313**	34,539
Non-current liabilities			
Convertible debenture	15	**93,154**	94,302
Decommissioning liability		**2,793**	2,308
Total non-current liabilities		**95,947**	96,610
Total liabilities		**140,260**	131,149
Equity			
Common shares		**1,067,848**	1,067,839
Share option reserve		**52,033**	51,198
Investment revaluation reserve		**1,501**	514
Accumulated deficit	17	**(812,539)**	(744,494)
Total equity		**308,843**	375,057
Total equity and liabilities		**$ 449,103**	$ 506,206
Net current assets		**$ 699**	$ 41,670
Total assets less current liabilities		**$ 404,790**	$ 471,667

Corporate information and going concern (Note 1), commitments for expenditure (Note 22) and contingencies (Note 23)

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

APPROVED BY THE BOARD:

"Andre Deepwell"	***"Pierre Lebel"***
Director	Director

SouthGobi Resources Ltd.

Condensed Consolidated Interim Statements of Changes in Equity

(Unaudited)

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

	Number of shares	Common shares	Share option reserve	Investment revaluation reserve	Accumulated deficit	Total
Balances, January 1, 2013	181,928	$ 1,059,710	$ 51,303	$ -	$ (507,030)	$ 603,983
Shares issued for:						
Interest settlement on convertible debenture	1,847	4,000	-	-	-	4,000
Employee share purchase plan	56	111	-	-	-	111
Share-based compensation charged to operations	-	-	138	-	-	138
Net loss for the period	-	-	-	-	(98,733)	(98,733)
Change in value of available-for-sale financial asset, net of tax	-	-	-	1,261	-	1,261
Balances, September 30, 2013	183,831	$ 1,063,821	$ 51,441	$ 1,261	$ (605,763)	$ 510,760
Balances, January 1, 2014	**187,309**	**$ 1,067,839**	**$ 51,198**	**$ 514**	**$ (744,494)**	**$ 375,057**
Shares issued for:						
Employee share purchase plan	**10**	**9**	**-**	**-**	**-**	**9**
Share-based compensation charged to operations	**-**	**-**	**835**	**-**	**-**	**835**
Net loss for the period	**-**	**-**	**-**	**-**	**(68,045)**	**(68,045)**
Change in value of available-for-sale financial asset, net of tax	**-**	**-**	**-**	**987**	**-**	**987**
Balances, September 30, 2014	**187,319**	**$ 1,067,848**	**$ 52,033**	**$ 1,501**	**$ (812,539)**	**$ 308,843**

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

SouthGobi Resources Ltd.

Condensed Consolidated Interim Statements of Cash Flows

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

	Notes	Nine months ended September 30, 2014	2013
Operating activities			
Loss before tax		**$ (67,499)**	$ (86,856)
Adjustments for:			
Depreciation and depletion		**25,514**	25,127
Share-based compensation	18	**835**	138
Finance costs	8	**15,500**	15,991
Finance income	8	**(1,268)**	(4,259)
Share of losses of joint venture	12	**60**	39
Interest paid		**(8,066)**	(8,119)
Commitment fee and front end fee		**(175)**	-
Income tax paid		**(13)**	-
Unrealized foreign exchange gain		**8**	633
Loss on disposal of property, plant and equipment		**-**	952
Impairment loss on available-for-sale financial asset	12	**1,766**	3,067
Impairment of inventories	11	**15,226**	22,727
Impairment of prepaid expenses and deposits		**3,405**	-
Impairment of property, plant and equipment		**277**	4,299
Net proceeds from disposal of mining license		**(1,273)**	-
Other adjustments		**-**	14
Operating cash flows before changes in non-cash working capital items		**(15,703)**	(26,247)
Net change in non-cash working capital items	21	**(782)**	22,972
Cash used in operating activities		**(16,485)**	(3,275)
Investing activities			
Expenditures on property, plant and equipment		**(3,649)**	(10,855)
Proceeds from disposal of property, plant and equipment		**-**	991
Interest received		**6**	86
Proceeds from maturity or disposal of short and long term investments		**135**	15,446
Net proceeds from disposal of mining license		**1,273**	-
Investment in joint venture		**(2,047)**	(6,086)
Cash generated from/(used in) investing activities		**(4,282)**	(418)
Financing activities			
Proceeds from issuance of common shares		**9**	111
Drawings under borrowing from immediate parent company		**3,800**	-
Cash generated from financing activities		**3,809**	111
Effect of foreign exchange rate changes on cash		**(111)**	(22)
Decrease in cash		**(17,069)**	(3,604)
Cash, beginning of period		**21,837**	19,674
Cash, end of period		**$ 4,768**	$ 16,070

Supplemental cash flow information (Note 21)

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

1. CORPORATE INFORMATION AND GOING CONCERN

SouthGobi Resources Ltd. is a publicly listed company incorporated in Canada with limited liability under the legislation of the Province of British Columbia and its shares are listed on the Toronto Stock Exchange (Symbol: SGQ) and Hong Kong Stock Exchange (Symbol: 1878). The company, together with its subsidiaries (collectively referred to as the “Company”), is an integrated coal mining, development and exploration company. The Company’s immediate parent company is Turquoise Hill Resources Ltd. (“Turquoise Hill”) and at September 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 producing coal mine (“Ovoot Tolgoi Mine”) and the following significant development projects, the Soumber Deposit, the Zag Suuj Deposit and the Ovoot Tolgoi Underground Deposit. These projects are located in the Umnugobi Aimag (South Gobi Province) of Mongolia, within 150 kilometers of each other and in close proximity to the Mongolia-China border. The Company owns a 100% interest in these coal projects.

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

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

Going concern assumption

Several adverse conditions and material uncertainties cast significant doubt upon the going concern assumption. The Company had cash of $4,768 and working capital (net current assets) of $699 at September 30, 2014. However, the Company anticipates that coal prices in the People’s Republic of China (“China”) will remain under pressure through the end of 2014 and the beginning of 2015, 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 and 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 is actively seeking sources of financing 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 September 30, 2015, then the Company is unlikely to have sufficient capital resources or cash flows from mining operations in order to satisfy its ongoing obligations and future contractual commitments, including cash interest payments due on the CIC convertible debenture. As a result, the Company may not be able to continue as a going concern. Therefore, the Company is also actively seeking additional sources of financing to continue operating and meet its objectives.

1. CORPORATE INFORMATION AND GOING CONCERN (CONTINUED)

The Company's consolidated financial statements have been prepared on a going concern basis which assumes that the Company will continue operating until at least September 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 upcoming 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 September 30, 2015, it will not have adequate liquidity to fund its operations and meet its obligations (including its debt payment obligations), it may not be able to continue as a going concern. If for any reason, the Company is unable to secure the additional sources of financing and continue as a going concern, then this could result in adjustments to the amounts and classifications of assets and liabilities in the Company's consolidated financial statements and such adjustments could be material.

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

2. BASIS OF PREPARATION

2.1 Statement of compliance

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

The condensed consolidated interim financial statements of the Company for the nine months ended September 30, 2014 were approved and authorized for issue by the Board of Directors of the Company on November 10, 2014.

2.2 Basis of presentation

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

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

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

2. BASIS OF PREPARATION (CONTINUED)

2.3 Adoption of new and revised standards and interpretations

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

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

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

2.4 Significant accounting judgments and estimates

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

Liquidity and going concern assumption

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

2. BASIS OF PREPARATION (CONTINUED)

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

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

Review of carrying value of assets and impairment charges

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

Ovoot Tolgoi Mine cash generating unit

The Company determined that an indicator of impairment existed for its Ovoot Tolgoi Mine cash generating unit as at September 30, 2014. The impairment indicator was the continued weakness in the Company's share price during the three months ended September 30, 2014 and the fact that the market capitalization of the Company, as at September 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 cash flow valuation model has been updated to take into consideration the latest available information to the Company, including but not limited to, sales price and washing assumptions, operating cost assumptions and life of mine coal production assumptions as at September 30, 2014. The Company's Ovoot Tolgoi Mine cash generating unit carrying value was $383,700 as at September 30, 2014.

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

- Long term real selling price of $103 per tonne for semi-soft coking coal FOB Australia;
- Updated life-of-mine coal production and operating costs; and
- A pre-tax discount rate of 15.3% based on an analysis of market, country and Company specific factors.

2. BASIS OF PREPARATION (CONTINUED)

Key sensitivities in the valuation model are as follows:

- For each 1% increase/(decrease) in the long term real selling price of semi-soft coal FOB Australia, the calculated value of the cash generating unit increases/(decreases) by approximately $21,100/($21,100); and
- For each 1% increase/(decrease) in the pre-tax discount rate, the calculated value of the cash generating unit (decreases)/increases by approximately ($28,100)/$31,100.

The impairment analysis did not result in the identification of an impairment loss and no charge was required as at September 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.

The Company is currently reviewing its mine plan for the Ovoot Tolgoi project. Changes to the mine plan may have an impact on the quantities of measured and/or indicated resources and reserves of the Ovoot Tolgoi project.

Review of carrying value of the prepaid toll washing fees

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

During the year ended December 31, 2011, the Company entered into an agreement with Ejinaqi Jinda Coal Industry Co. Ltd. ("Ejin Jinda"), a subsidiary of China Mongolia Coal Co. Ltd., to toll wash coal from the Ovoot Tolgoi Mine. The agreement has a duration of 5-years from commencement and provides for an annual wet washing capacity of approximately 3.5 million tonnes of input raw coal.

Commercial operations at the Ejin Jinda wet washing facility have not commenced. The Company identified the results of a trial sample from the wet washing facility and the delay in starting the commercial operations at the wet washing facility as indicators of impairment for the prepaid toll washing fees which are part of the contract with Ejin Jinda. Based on updated estimates and assumptions related to wash yields from the facility and potential fees to early cancel the contract (Note 22), a $30,152 impairment loss on the $33,556 of prepaid toll washing fees was recorded in other operating expenses during the year ended December 31, 2013. During the second quarter of 2014, the Company recorded an additional impairment of $3,404 against the prepaid toll washing fees to fully impair the deposit due to the continued delay in starting the commercial operations at the wet washing facility and the continued soft coal market in China. There has been no change in the assessment of impairment in the third quarter of 2014.

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

3. SEGMENTED INFORMATION

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

During the nine months ended September 30, 2014, the Mongolian Coal Division had 5 active customers with the largest customer accounting for 33% of revenues, the second and the third largest customer accounting for 30% and 25% of revenue, respectively.

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

	Mongolian Coal Division	Unallocated (i)	Consolidated Total
Segment assets			
As at September 30, 2014	**$ 440,686**	**$ 8,417**	**$ 449,103**
As at December 31, 2013	490,949	15,257	506,206
Segment liabilities			
As at September 30, 2014	**$ 24,128**	**$ 116,132**	**$ 140,260**
As at December 31, 2013	25,393	105,756	131,149
Segment loss			
For the three months ended September 30, 2014	**$ (17,060)**	**$ (7,059)**	**$ (24,119)**
For the three months ended September 30, 2013	(33,860)	(8,068)	(41,928)
For the nine months ended September 30, 2014	**$ (46,444)**	**$ (21,601)**	**$ (68,045)**
For the nine months ended September 30, 2013	(75,823)	(22,910)	(98,733)
Segment revenues			
For the three months ended September 30, 2014	**$ 7,611**	**$ -**	**$ 7,611**
For the three months ended September 30, 2013	15,652	-	15,652
For the nine months ended September 30, 2014	**$ 19,440**	**$ -**	**$ 19,440**
For the nine months ended September 30, 2013	26,179	-	26,179
Impairment charge on assets (ii)			
For the three months ended September 30, 2014	**$ 1,698**	**$ -**	**$ 1,698**
For the three months ended September 30, 2013	10,826	-	10,826
For the nine months ended September 30, 2014	**$ 18,907**	**$ 1,766**	**$ 20,673**
For the nine months ended September 30, 2013	27,026	3,067	30,093

(i) The unallocated amount contains all amounts associated with the Corporate Division.
(ii) The impairment charge on assets for the three and nine months ended September 30, 2014 and 2013 relates to trade and other receivables (Note 10), prepaid expenses and deposits, inventories (Note 11) and investments (Note 12).

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

3. SEGMENTED INFORMATION (CONTINUED)

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

	Mongolia	Hong Kong	Canada	Consolidated Total
Revenues				
For the three months ended September 30, 2014	**$ 7,611**	**$ -**	**$ -**	**$ 7,611**
For the three months ended September 30, 2013	15,652	-	-	15,652
For the nine months ended September 30, 2014	**$ 19,440**	**$ -**	**$ -**	**$ 19,440**
For the nine months ended September 30, 2013	26,179	-	-	26,179
Non-current assets				
As at September 30, 2014	**$ 397,798**	**$ 30**	**$ 6,263**	**$ 404,091**
As at December 31, 2013	422,679	81	7,237	429,997

4. COST OF SALES

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

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Operating expenses	**$ 6,259**	$ 10,927	**$ 18,576**	$ 20,207
Share-based compensation expense (Note 18)	**90**	(167)	**232**	(320)
Depreciation and depletion	**1,742**	7,389	**6,283**	9,905
Impairment of coal stockpile inventories (Note 11)	**1,698**	10,826	**15,226**	15,797
Cost of sales from mine operations	**9,789**	28,975	**40,317**	45,589
Cost of sales related to idled mine assets (i)	**14,133**	4,511	**22,058**	26,679
Cost of sales	**$ 23,922**	$ 33,486	**$ 62,375**	$ 72,268

(i) Cost of sales related to idled mine assets for the three months ended September 30, 2014 includes $10,891 of depreciation expense (2013: $4,460). Cost of sales related to idled mine assets for the nine months ended September, 2014 includes $18,738 of depreciation expense (2013: $21,332). The depreciation expense relates to the Company’s idled plant and equipment.

The Company’s mining activities remained fully curtailed from January 1, 2013 until March 22, 2013, when the Company recommenced mining activities at the Ovoot Tolgoi Mine. The idled mine asset depreciation expense for the nine months ended September 30, 2013 relates to the Company’s idled plant and equipment during the curtailment of its mining activities. The idled mine asset depreciation expense for the three and nine months ended September 30, 2014 relates to the Company’s idled plant and equipment as the production plan during the three and nine months ended September 30, 2014 did not fully utilize the Company’s existing mining fleet. In Mid-June, the Company placed approximately half of its workforce on furlough and reduced its mining activities accordingly. The furlough is anticipated to remain in place until end of November, 2014 subject to market conditions. The idled mine asset depreciation expenses for the three months and nine months ended September 30, 2014 relates to the Company’s idled plant and equipment during the period.

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

5. OTHER OPERATING EXPENSES

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

	Three months ended September 30, 2014	Three months ended September 30, 2013	Nine months ended September 30, 2014	Nine months ended September 30, 2013
Public infrastructure	**$ -**	$ -	**$ -**	$ 6
Sustainability and community relations	**82**	37	**211**	118
Foreign exchange loss/(gain)	**(80)**	637	**(990)**	1,028
Mark-to-market loss on available-for-sale financial asset (Note 12)	**-**	-	**1,766**	3,067
Loss on disposal of property, plant and equipment (Note 13)	**-**	329	**-**	895
Impairment of property, plant and equipment (Note 13)	**-**	-	**277**	4,299
Impairment of prepaid expenses and deposits	**-**	-	**3,405**	-
Impairment of materials and supplies inventories	**-**	-	**-**	6,930
Proceeds from disposal of mining license	**-**	-	**(1,818)**	-
Other	**-**	-	**-**	15
Other operating expenses	**$ 2**	$ 1,003	**$ 2,851**	$ 16,358

6. ADMINISTRATION EXPENSES

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

	Three months ended September 30, 2014	Three months ended September 30, 2013	Nine months ended September 30, 2014	Nine months ended September 30, 2013
Corporate administration	**$ 544**	$ 857	**$ 1,727**	$ 2,980
Professional fees	**971**	2,338	**2,437**	5,968
Salaries and benefits	**627**	807	**2,180**	2,414
Share-based compensation expense (Note 18)	**355**	167	**580**	440
Depreciation	**33**	35	**96**	156
Administration expenses	**$ 2,530**	$ 4,204	**$ 7,020**	$ 11,958

7. EVALUATION AND EXPLORATION EXPENSES

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

	Three months ended September 30, 2014	Three months ended September 30, 2013	Nine months ended September 30, 2014	Nine months ended September 30, 2013
Direct expenses	**$ 6**	$ 11	**$ 132**	$ 40
License fees	**6**	158	**6**	503
Share-based compensation expense (Note 18)	**8**	5	**22**	18
Overhead and other	**102**	12	**241**	119
Evaluation and exploration expenses	**$ 122**	$ 186	**$ 401**	$ 680

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

8. FINANCE COSTS AND INCOME

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

	Three months ended, September 30,		Nine months ended, September 30,	
	2014	**2013**	**2014**	**2013**
Interest expense on convertible debenture (Note 15)	**$ 5,078**	$ 5,186	**$ 15,064**	$ 15,217
Unrealized loss on FVTPL investments [(i)]	**6**	128	**57**	596
Interest expense on line of credit facility	**-**	-	**-**	11
Interest expense on borrowing (Note 16)	**108**	-	**132**	-
Commitment fee and front end fee (Note 16)	**41**	-	**175**	-
Realized loss on disposal of FVTPL investments	**-**	38	**2**	82
Accretion of decommissioning liability	**24**	30	**70**	85
Finance costs	**$ 5,257**	$ 5,382	**$ 15,500**	$ 15,991

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

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

	Three months ended, September 30,		Nine months ended, September 30,	
	2014	**2013**	**2014**	**2013**
Unrealized gain on embedded derivatives in convertible debenture (Note 15)	**$ 133**	$ 113	**$ 1,253**	$ 4,204
Interest income	**2**	11	**15**	55
Finance income	**$ 135**	$ 124	**$ 1,268**	$ 4,259

9. LOSS PER SHARE

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

	Three months ended September 30,		Nine months ended September 30,	
	2014	**2013**	**2014**	**2013**
Net loss	**$ (24,119)**	$ (41,928)	**$ (68,045)**	$ (98,733)
Weighted average number of shares	**187,319**	182,204	**187,315**	182,038
Basic and diluted loss per share	**$ (0.13)**	$ (0.23)	**$ (0.36)**	$ (0.54)

Potentially dilutive items not included in the calculation of diluted loss per share include the convertible debenture (Note 15) and stock options (Note 18) that were anti-dilutive.

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

10. TRADE AND OTHER RECEIVABLES

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

	As at	
	September 30, 2014	December 31, 2013
Trade receivables	**$ 565**	$ 1,818
Other receivables	**159**	760
Total trade and other receivables	**$ 724**	$ 2,578

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

	As at	
	September 30, 2014	December 31, 2013
Less than 1 month	**$ 18**	$ 396
1 to 3 months	**45**	1,321
3 to 6 months	**600**	141
Over 6 months	**61**	720
Total trade and other receivables	**$ 724**	$ 2,578

Included in trade and other receivables are amounts due from related parties which are further disclosed in Note 20. The amounts due from related parties are unsecured, interest free and repayable upon written notice from the Company.

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

11. INVENTORIES

The Company's inventories consist of the following amounts:

	As at	
	September 30, 2014	December 31, 2013
Coal stockpiles	**$ 5,356**	$ 8,305
Materials and supplies	**29,859**	31,983
Total inventories	**$ 35,215**	$ 40,288

As at September 30, 2014, the coal stockpiles includes inventory held by a third party of $817. (December 31, 2013: nil). Cost of sales for the three and nine months ended September 30, 2014 includes an impairment loss of $1,698 and $15,226, respectively, related to the Company's coal stockpile inventories (For three and nine months ended September 2013: $10,826 and $15,797, respectively). As at September 30, 2014, $4,129 of the Company's coal stockpile inventories are carried at their net realizable value (December 31, 2013: $4,853).

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

12. INVESTMENTS

The Company's investments consist of the following amounts:

	As at	
	September 30, 2014	**December 31, 2013**
Non-current investments at fair value		
Investment in Kangaroo Resources Limited [(i)]	**$ 28**	$ 222
Investment in Aspire Mining Limited [(ii)]	**5,395**	6,175
Non-current investment in joint venture		
Investment in RDCC LLC	**26,530**	24,205
Total investments	**$ 31,953**	$ 30,602

(i) At September 30, 2014, the Company owned 0.1% of Kangaroo's issued and outstanding shares. (December 31, 2013: 0.5%)
(ii) At September 30, 2014, the Company owned 17.6% of Aspire's issued and outstanding shares. (December 31, 2013: 18.8%)

12.1 Investment in Kangaroo Resources Limited

Kangaroo Resources Limited ("Kangaroo") is a company listed on the Australian Securities Exchange. Kangaroo's primary focus is its coal projects in Indonesia. The Company classifies its investment in Kangaroo as a FVTPL financial asset with any change in value being recognized in profit or loss. During the three months ended September 30, 2014, the Company disposed of 6,551 shares of Kangaroo for gross proceeds of $61. During the nine months ended September 30, 2014, the Company disposed of 14,264 shares of Kangaroo for gross proceeds of $135. For the three months ended September 30, 2014, the Company recognized an unrealized mark to market loss of $6 related to its investment in Kangaroo (2013: unrealized loss of $128). For the nine months ended September 30, 2014, the Company recognized an unrealized mark to market loss of $57 related to its investment in Kangaroo (2013: unrealized loss of $596).

12.2 Investment in Aspire Mining Limited

Aspire Mining Limited ("Aspire") is a company listed on the Australian Securities Exchange. Aspire's primary focus is its mineral exploration and mining licenses in Mongolia, particularly those pertaining to the Ovoot Coking Coal Project. The Company classifies its investment in Aspire as an available-for-sale financial asset. For the three months ended September 30, 2014, the Company recognized an unrealized gain, net of tax, of $1,087 in other comprehensive income (2013: unrealized gain of $1,261). For the nine months ended September 30, 2014, the Company recognized an impairment loss of $1,766 in other operating expenses and an unrealized gain, net of tax, of $987 in other comprehensive income (2013: impairment loss of $3,067 recognized in other operating expenses and an unrealized gain, net of tax, of $1,261 in other comprehensive income).

12.3 Investment in RDCC LLC

The Company has a 40% interest in RDCC LLC, a joint venture. RDCC LLC has signed a concession agreement with the State Property Committee of Mongolia to construct a paved highway from the Company's Ovoot Tolgoi Mine to the Mongolia-China border. The Company announced on September 28, 2014 the construction of the paved highway had been fully completed. The concession agreement is structured as a 17-year build, operate and transfer agreement.

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

12. INVESTMENTS (CONTINUED)

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

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

	Three months ended September 30,		Nine months ended September 30,	
	2014	**2013**	**2014**	**2013**
Balance, beginning of period	**$ 24,514**	$ 15,508	**$ 24,205**	$ 13,902
Funds advanced	**2,048**	4,507	**2,385**	6,086
Share of losses of joint venture	**(32)**	(66)	**(60)**	(39)
Balance, end of period	**$ 26,530**	$ 19,949	**$ 26,530**	$ 19,949

For the three and nine months ended September 30, 2014, RDCC LLC recognized construction revenue of $nil and $5,448, respectively, with a profit margin of $nil related to the construction of the paved highway. For the three and nine months ended September 30, 2014, RDCC LLC had a net loss of $78 and $150, respectively. For the three and nine months ended September 30, 2013, RDCC LLC has a net loss of $165 and $98, respectively.

13. PROPERTY, PLANT AND EQUIPMENT

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

	Mobile equipment	Other operating equipment	Buildings and roads	Mineral properties	Construction in progress	Total
Cost						
As at December 31, 2013	$ 363,689	$ 28,350	$ 72,214	$ 127,068	$ 6,276	$ 597,597
Additions	**3,919**	**326**	**14**	**6,517**	**-**	**10,776**
Disposals	**(826)**	**(56)**	**-**	**-**	**(42)**	**(924)**
Impairment charges	**-**	**-**	**-**	**-**	**(277)**	**(277)**
Reclassifications	**-**	**-**	**(34)**	**-**	**34**	**-**
As at September 30, 2014	**$ 366,782**	**$ 28,620**	**$ 72,194**	**$ 133,585**	**$ 5,991**	**$ 607,172**
Accumulated depreciation						
As at December 31, 2013	$ (138,627)	$ (17,231)	$ (27,454)	$ (14,890)	$ -	$ (198,202)
Charge for the period	**(30,646)**	**(2,025)**	**(4,260)**	**(779)**	**-**	**(37,710)**
Eliminated on disposals	**826**	**52**	**-**	**-**	**-**	**878**
As at September 30, 2014	**$ (168,447)**	**$ (19,204)**	**$ (31,714)**	**$ (15,669)**	**$ -**	**$ (235,034)**
Carrying amount						
As at December 31, 2013	$ 225,062	$ 11,119	$ 44,760	$ 112,178	$ 6,276	$ 399,395
As at September 30, 2014	**$ 198,335**	**$ 9,416**	**$ 40,480**	**$ 117,916**	**$ 5,991**	**$ 372,138**

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

13. PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

13.1 Prepayments on property, plant and equipment

As at September 30, 2014, the cost of the Company's property, plant and equipment includes $36,600 of prepayments to vendors (December 31, 2013: $41,240). The prepayments primarily relate to ordered but not yet delivered mobile equipment or mobile equipment delivered to the location of its intended use but not yet commissioned.

14. TRADE AND OTHER PAYABLES

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

	As at	
	September 30, 2014	December 31, 2013
Less than 1 month	**$ 6,644**	$ 28,786
1 to 3 months	**3,171**	554
3 to 6 months	**6,899**	367
Over 6 months	**789**	1,534
Total trade and other payables	**$ 17,503**	$ 31,241

Included in trade and other payables are amounts due to related parties which are further disclosed in Note 20.

15. CONVERTIBLE DEBENTURE

15.1 Key commercial terms

On November 19, 2009, the Company issued a convertible debenture to a wholly owned subsidiary of CIC for $500,000. The convertible debenture bears interest at 8.0% per annum (6.4% payable semi-annually in cash and 1.6% payable annually in the Company's shares) and has a maximum term of 30 years. The convertible debenture is secured by a first charge over the Company's assets, including shares of its material subsidiaries. An event of default on the convertible debenture can be triggered as a result of certain encumbrances on the Company's assets (refer to Note 23.2).

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

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

15. CONVERTIBLE DEBENTURE (CONTINUED)

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

15.2 Debt host and embedded derivatives

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

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

15.3 Valuation assumptions

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

	As at	
	September 30, 2014	**December 31, 2013**
Floor conversion price	**Cdn$8.88**	Cdn$8.88
Ceiling conversion price	**Cdn$11.88**	Cdn$11.88
Common share price	**Cdn$0.61**	Cdn$0.84
Historical volatility	**69%**	71%
Risk free rate of return	**2.56%**	3.11%
Foreign exchange spot rate (Cdn$ to U.S. Dollar)	**0.89**	0.94
Forward foreign exchange rate curve (Cdn$ to U.S. Dollar)	**0.88 - 0.89**	0.92 - 0.94

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

15. CONVERTIBLE DEBENTURE (CONTINUED)

15.4 Presentation

Based on the Company's valuation as at September 30, 2014, the fair value of the embedded derivatives decreased by $133 and $1,253 compared to June 30, 2014 and December 31, 2013, respectively. The decrease was recorded as finance income for the three and nine months ended September 30, 2014.

For the three months ended September 30, 2014, the Company recorded interest expense of $5,079 related to the convertible debenture as a finance cost (2013: $5,186). For the nine months ended September 30, 2014, the Company recorded interest of $15,064 related to the convertible debenture as a finance cost (2013: $15,218). The interest expense consists of the interest at the contract rate and the accretion of the debt host component of the convertible debenture. To calculate the accretion expense, the Company uses the contract life of 30 years and an effective interest rate of 22.2%.

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

	Three months ended September 30,		Nine months ended September 30,	
	2014	**2013**	**2014**	**2013**
Balance, beginning of period	**$ 97,534**	$ 107,909	**$ 96,603**	$ 105,968
Interest expense on convertible debenture	**5,079**	5,186	**15,064**	15,218
Decrease in fair value of embedded derivatives	**(133)**	(113)	**(1,253)**	(4,204)
Interest paid	**-**	(8,108)	**(7,934)**	(12,108)
Balance, end of period	**$ 102,480**	$ 104,874	**$ 102,480**	$ 104,874

The convertible debenture balance consists of the following amounts:

	As at	
	September 30, 2014	**December 31, 2013**
Current convertible debenture		
Interest payable	**$ 9,326**	$ 2,301
Non-current convertible debenture		
Debt host	**91,013**	90,907
Fair value of embedded derivatives	**2,141**	3,395
	93,154	94,302
Total convertible debenture	**$ 102,480**	$ 96,603

16. INTEREST-BEARING BORROWING

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

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

The Turquoise Hill Loan Facility matured on August 30, 2014. As a result, subject to certain conditions and limitations, Turquoise Hill agreed to grant a deferral of payment and repayment of all amounts and obligations owing by the Company under the Turquoise Hill Loan Facility and it will not enforce its rights under the Turquoise Hill Loan Facility to demand such payment and repayment upon the maturity date of August 30, 2014. This deferral of payment and repayment is granted to the Company without prejudice to Turquoise Hill’s right and ability to assert and re-assert at any point in time to demand payment and repayment of all amounts owing to Turquoise Hill under the Turquoise Hill Loan Facility.

As at August 29, 2014 the Company had drawn down $3,800 under this facility and the Company is not eligible to draw down any further amounts under the Turquoise Hill Loan Facility.

Turquoise Hill has confirmed that subject to certain conditions and limitations, it agrees to grant deferral of payment and repayment of all amounts and obligations owing by the Company under the Turquoise Hill Loan Facility and it will not enforce its rights under the Turquoise Hill Loan Facility to demand such payment and repayment upon the maturity date of August 30, 2014. However, if (i) the Sale and Purchase Agreement entered into between Turquoise Hill and National United Resources Holdings Limited (“NUR”) as announced on July 30, 2014 (the “NUR SPA”) is terminated by any party thereto for any reason, (ii) the transaction contemplated by the NUR SPA shall not have been completed by November 30, 2014 or (iii) NUR is in breach of any of its obligations, covenants or undertakings under the NUR SPA, Turquoise Hill shall be immediately and automatically entitled to enforce its rights under the Turquoise Hill Loan Facility to demand payment and repayment of all amounts and obligations owing by the Company. This deferral of payment and repayment is granted to the Company without prejudice to Turquoise Hill’s right and ability to assert and re-assert at any point in time to demand payment and repayment of all amounts owing to Turquoise Hill under the Turquoise Hill Loan Facility.

In addition, Turquoise Hill has also agreed that in the event the transaction contemplated the NUR SPA shall have been completed by November 30, 2014 strictly in accordance with the terms and conditions of the NUR SPA, Turquoise Hill would agree to defer repayment of amounts and obligations due by the Company under the Turquoise Hill Loan Facility as follows:

(i) US$1,900 in principal and all interest that has accrued on and under the Turquoise Hill Loan Facility up to and including December 31, 2014 shall become due and payable on December 31, 2014; and

16. INTEREST-BEARING BORROWING (CONTINUED)

(ii) US$1,900 in principal and all interest that has accrued on and under the Turquoise Hill Loan Facility from January 1, 2015 up to and including March 31, 2015 shall become due and payable on March 31, 2015.

As at September 30, 2014 the Company had drawn down $3,800 and interest payable of $35 under this facility. (December 31, 2013: nil). Included in the interest-bearing borrowing amounts due to related parties which are further disclosed in Note 20.

17. EQUITY

17.1 Share capital

The Company has authorized an unlimited number of common and preferred shares with no par value. At September 30, 2014, the Company had 187,319 common shares outstanding (December 31, 2013: 187,309) and no preferred shares outstanding (December 31, 2013: nil). The Company's volume weighted average share price for the nine months ended September 30, 2014 was Cdn$0.66 (2013: Cdn$1.85).

17.2 Accumulated deficit and dividends

At September 30, 2014, the Company has accumulated a deficit of $812,539 (December 31, 2013: $744,494). No dividends have been paid or declared by the Company since inception.

18. SHARE-BASED PAYMENTS

18.1 Stock option plan

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

For the nine months ended September 30, 2014, the Company granted 1,924 stock options (2013: 282) to officers, employees, directors and other eligible persons at exercise prices ranging from Cdn$0.58 to Cdn$0.84 (2013: exercise price of Cdn$1.16 to Cdn$2.10) and expiry dates ranging from January 13, 2019 to August 13, 2019 (2013: expiry date of March 27, 2018 to August 14, 2018). The weighted average fair value of the options granted in the nine months ended September 30, 2014 was estimated at $0.22 (Cdn$0.25) (2013: $0.6, Cdn$0.62) per option at the grant date using the Black-Scholes option pricing model.

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

18. SHARE-BASED PAYMENTS (CONTINUED)

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

	Nine months ended September 30, 2014	Nine months ended September 30, 2013
Risk free interest rate	**1.36%**	**1.56%**
Expected life	**3.3 years**	**3 years**
Expected volatility [(i)]	**56%**	**56%**
Expected dividend per share	**$nil**	**$nil**

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

A share-based compensation expense of $373 for the options granted in the nine months ended September 30, 2014 (2013: $151) will be amortized over the vesting period, of which $63 was recognized in the nine months ended September 30, 2014 (2013: $31).

The total share-based compensation expense for the three months ended September 30, 2014 was $453 (2013: $5). Share-based compensation expense of $355 (2013: $167) has been allocated to administration expenses, $90 (2013: recovery of $167) has been allocated to cost of sales and $8 (2013: $5) has been allocated to evaluation and exploration expenses.

The total share-based compensation expense for the nine months ended September 30, 2014 was $835 (2013: $138). Share-based compensation expense of $580 (2013: $440) has been allocated to administration expenses, $233 (2013: recovery of $320) has been allocated to cost of sales and $22 (2013: $18) has been allocated to evaluation and exploration expenses.

18.2 Outstanding stock options

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

	Nine months ended September 30, 2014			Nine months ended September 30, 2013		
	Number of options		Weighted average exercise price (Cdn$)	Number of options		Weighted average exercise price (Cdn$)
Balance, beginning of period	**2,583**	**$**	**8.48**	**7,507**	**$**	**9.72**
Options granted	**1,924**		**0.60**	**282**		**1.37**
Options forfeited	**(236)**		**1.52**	**(626)**		**7.32**
Options expired	**(1,130)**		**9.90**	**(4,107)**		**10.67**
Balance, end of period	**3,141**	**$**	**3.67**	**3,056**	**$**	**8.16**

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

18. SHARE-BASED PAYMENTS (CONTINUED)

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

	Options Outstanding				Options Exercisable			
Exercise price (Cdn$)	Options outstanding		Weighted average exercise price (Cdn$)	Weighted average remaining contractual life (years)	Options outstanding and exercisable		Weighted average exercise price (Cdn$)	Weighted average remaining contractual life (years)
0.58 to 1.92	**2,189**	**$**	**0.78**	**4.55**	**184**	**$**	**1.62**	**3.46**
6.16 to 9.43	**492**		**8.20**	**2.10**	**450**		**8.40**	**2.07**
12.58	**460**		**12.58**	**0.87**	**460**		**12.58**	**0.87**
	3,141	**$**	**3.67**	**3.63**	**1,094**	**$**	**9.01**	**1.80**

19. FAIR VALUE MEASUREMENTS

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

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

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

	As at September 30, 2014							
Recurring measurements		**Level 1**		**Level 2**		**Level 3**		**Total**
Financial assets at fair value								
Investment in Aspire	**$**	**5,395**	**$**	**-**	**$**	**-**	**$**	**5,395**
Investment in Kangaroo		**28**		**-**		**-**		**28**
Total financial assets at fair value	**$**	**5,423**	**$**	**-**	**$**	**-**	**$**	**5,423**
Financial liabilities at fair value								
Convertible debenture - embedded derivatives	**$**	**-**	**$**	**2,141**	**$**	**-**	**$**	**2,141**
Total financial liabilities at fair value	**$**	**-**	**$**	**2,141**	**$**	**-**	**$**	**2,141**

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

19. FAIR VALUE MEASUREMENTS (CONTINUED)

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

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

20. RELATED PARTY TRANSACTIONS

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

- Turquoise Hill – Turquoise Hill is the Company's immediate parent company and at September 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 September 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 Note 23.3.
- 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.

20.1 Related party expenses

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

	Three months ended September 30,		Nine months ended September 30,	
	2014	**2013**	**2014**	**2013**
Corporate administration	**$ 263**	$ 214	**$ 636**	$ 595
Salaries and benefits	**235**	685	**1,135**	1,167
Finance cost	**148**	-	**305**	-
Related party expenses	**$ 646**	$ 899	**$ 2,076**	$ 1,762

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

20. RELATED PARTY TRANSACTIONS (CONTINUED)

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

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
GMM	**$ -**	$ 2	**$ -**	$ 59
Turquoise Hill	**224**	93	**465**	192
Rio Tinto	**223**	611	**1,133**	1,001
Turquoise Hill Singapore	**199**	193	**478**	510
Related party expenses	**$ 646**	$ 899	**$ 2,076**	$ 1,762

20.2 Related party expense recoveries

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

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Corporate administration	**$ -**	$ 7	**$ 17**	$ 14

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

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Turquoise Hill	**$ -**	$ -	**$ 17**	$ -
Rio Tinto	**-**	7	**-**	14
Related party expense recovery	**$ -**	$ 7	**$ 17**	$ 14

20.3 Related party assets

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

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

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

20. RELATED PARTY TRANSACTIONS (CONTINUED)

20.4 Related party liabilities

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

	As at	
	September 30, 2014	December 31, 2013
Amounts payable to Rio Tinto	**$ 7,745**	$ 1,375
Accounts payable to Turquoise Hill Singapore	**257**	-
Accounts payable to Turquoise Hill	**4,074**	34
Total liabilities due to related parties	**$ 12,076**	$ 1,409

Included in the accounts payable to Turquoise Hill, the Company had interest-bearing borrowings of $3,800 and interest payable of $35 with related parties as at September 30, 2014 (December 31, 2013: nil). Details are further disclosed in Note 16.

21. SUPPLEMENTAL CASH FLOW INFORMATION

21.1 Net change in non-cash working capital items

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

	Nine months ended September 30,	
	2014	2013
Decrease/(increase) in inventories	**$ (1,022)**	$ 5,751
Decrease/(increase) in trade and other receivables	**1,658**	(4,776)
Decrease in prepaid expenses and deposits	**1,126**	11,300
Increase/(decrease) in trade and other payables	**(15,196)**	10,483
Increase in deferred revenue	**12,652**	214
Net change in non-cash working capital items	**$ (782)**	$ 22,972

22. COMMITMENTS FOR EXPENDITURE

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

	As at September 30, 2014			
	Within 1 year	2-3 years	Over 3 years	Total
Capital expenditure commitments	**$ 16,147**	**$ 7,971**	**$ -**	**$ 24,118**
Operating expenditure commitments (i)	**22,236**	**102**	**406**	**22,744**
Commitments	**$ 38,383**	**$ 8,073**	**$ 406**	**$ 46,862**

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

23. CONTINGENCIES

23.1 Governmental and regulatory investigations

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

While the IAAC investigation into allegations of possible breaches of Mongolian anti-corruption laws has been suspended, the Company has not received formal notice that the IAAC investigation is completed. The IAAC has not formally accused any current or former Company employees of breach of Mongolia's anti-corruption laws.

A report issued by the experts appointed by the SIA on June 30, 2013 and again in January 2014 has recommended that the accusations of money laundering as alleged against the Company's three (3) 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 (3) 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 had 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 was deferred until August 25, 2014.

The trial commenced on August 25, 2014 and following two (2) days of hearing, the panel of three (3) appointed judges ordered the matter be returned to the Prosecutor General for further investigations. The Court's decision is mainly based on the following findings during the hearing:

(i) lack of clarity as to the nature and scope of which the three (3) former employees are being accused;

(ii) insufficient evidence with respect to the accusations;

(iii) significant variations in the conclusions reached by the different investigations during the investigative period over the same allegations against the three (3) former employees and SouthGobi Sands LLC; and

(iv) the investigators failed to review and consider all the information and documents provided by SouthGobi Sands LLC to the investigators.

23. CONTINGENCIES (CONTINUED)

On October 7, 2014 the Mongolian investigation authority issued a resolution to order a re-investigation and new investigators to the case were appointed under that resolution.

As the case has been returned for further investigations, 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 (3) 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. As at September 30, 2014, this $1.5 million is included within the prepaid expenses and deposits balance in the Company's financial statements. While the orders restrict the use of in-country funds pending the outcome of the investigation, they are not expected to have a material impact on the Company's activities in the short term, although they could create potential difficulties for the Company in the medium to long term. The Company will continue to take all appropriate steps to protect its ability to conduct its business activities in the ordinary course.

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

23.2 Mongolian IAAC investigation

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

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

23. CONTINGENCIES (CONTINUED)

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

23.3 Internal investigations

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

The investigations referred to above could result in one or more Mongolian, Canadian, United States or other governmental or regulatory agencies taking civil or criminal action against the Company, its affiliates or its current or former employees. The likelihood or consequences of such an outcome are unclear at this time but could include financial or other penalties, which could be material, and which could have a material adverse effect on the Company.

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

23.4 Class action lawsuit

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

There have been no significant developments in respect of the class action lawsuit since the first quarter ended March 31, 2014.

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, the Company has judged a provision for this matter as at September 30, 2014 is not required.

24. Subsequent event

On October 31, 2014, the Company sold 63,498 shares or 51.4 % of its stake in Aspire for net proceeds totaling $1,372. At November 10, 2014, the Company owned 60,000 shares or 8.5% of Aspire's issued and outstanding shares.