



# **SouthGobi Resources Ltd.**

## **Condensed Consolidated Interim Financial Statements**

**June 30, 2018**

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

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# SOUTHGOBI RESOURCES LTD.

## Condensed Consolidated Interim Statement of Comprehensive Income

(Unaudited)

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

	Notes	Three months ended June 30,		Six months ended June 30,	
		2018	2017	2018	2017
Revenue	4	\$ 17,377	\$ 34,665	\$ 40,600	\$ 59,919
Cost of sales	6	(15,078)	(27,385)	(31,585)	(51,144)
<b>Gross profit</b>		<b>2,299</b>	<b>7,280</b>	<b>9,015</b>	<b>8,775</b>
Other operating expenses	7	(18,091)	(4,045)	(19,429)	(7,253)
Administration expenses		(3,856)	(2,234)	(6,233)	(4,619)
Evaluation and exploration expenses		(156)	(144)	(280)	(173)
<b>Profit/(loss) from operations</b>		<b>(19,804)</b>	<b>857</b>	<b>(16,927)</b>	<b>(3,270)</b>
Finance costs	8	(5,958)	(5,494)	(11,932)	(11,169)
Finance income	8	140	50	366	14
Share of earnings of a joint venture	15	628	388	968	654
<b>Loss before tax</b>		<b>(24,994)</b>	<b>(4,199)</b>	<b>(27,525)</b>	<b>(13,771)</b>
Current income tax expense	9	(1,609)	(2,714)	(2,538)	(2,759)
<b>Net loss attributable to equity holders of the Company</b>		<b>(26,603)</b>	<b>(6,913)</b>	<b>(30,063)</b>	<b>(16,530)</b>
<b>Other comprehensive income to be reclassified to profit or loss in subsequent periods</b>					
Exchange difference on translation of foreign operation		898	684	(2,430)	943
<b>Net comprehensive loss attributable to equity holders of the Company</b>		<b>\$ (25,705)</b>	<b>\$ (6,229)</b>	<b>\$ (32,493)</b>	<b>\$ (15,587)</b>
<b>Basic and diluted loss per share</b>		<b>\$ (0.10)</b>	<b>\$ (0.03)</b>	<b>\$ (0.11)</b>	<b>\$ (0.06)</b>

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

# SOUTHGOBI RESOURCES LTD.

## Condensed Consolidated Interim Statement of Financial Position

(Unaudited)

(Expressed in thousands of U.S. Dollars)

	Notes	As at	
		June 30, 2018	December 31, 2017
<b>Assets</b>			
<b>Current assets</b>			
Cash and cash equivalents		\$ 468	\$ 6,471
Trade and other receivables	11	12,015	16,486
Notes receivables	12	76	12,520
Inventories	13	38,432	36,389
Prepaid expenses and deposits		9,997	6,286
<b>Total current assets</b>		<b>60,988</b>	<b>78,152</b>
<b>Non-current assets</b>			
Properties for resale		\$ 8,777	\$ 8,906
Property, plant and equipment	14	155,736	152,457
Investment in a joint venture	15	20,589	21,052
<b>Total non-current assets</b>		<b>185,102</b>	<b>182,415</b>
<b>Total assets</b>		<b>\$ 246,090</b>	<b>\$ 260,567</b>
<b>Equity and liabilities</b>			
<b>Current liabilities</b>			
Trade and other payables	16	\$ 86,654	\$ 79,219
Deferred revenue		26,942	27,644
Provision for commercial arbitration	17	14,338	13,884
Interest-bearing borrowings	18	7,361	7,352
Convertible debenture	19	128,595	116,374
<b>Total current liabilities</b>		<b>263,890</b>	<b>244,473</b>
<b>Non-current liabilities</b>			
Interest-bearing borrowings	18	64	341
Decommissioning liability		5,378	5,213
<b>Total non-current liabilities</b>		<b>5,442</b>	<b>5,554</b>
<b>Total liabilities</b>		<b>269,332</b>	<b>250,027</b>
<b>Equity</b>			
Common shares	20	1,098,629	1,098,623
Share option reserve		52,500	52,463
Exchange reserve		(7,167)	(4,737)
Accumulated deficit	20	(1,167,204)	(1,135,809)
<b>Total equity</b>		<b>(23,242)</b>	<b>10,540</b>
<b>Total equity and liabilities</b>		<b>\$ 246,090</b>	<b>\$ 260,567</b>
<b>Net current liabilities</b>		<b>\$ (202,902)</b>	<b>\$ (166,321)</b>
<b>Total assets less current liabilities</b>		<b>\$ (17,800)</b>	<b>\$ 16,094</b>

Corporate information and going concern (Note 1), commitments for expenditure (Note 25) and contingencies (Note 26)

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

APPROVED BY THE BOARD:

"Mao Sun"

Director

"Shouguo Wang"

Director

# SOUTHGOBI RESOURCES LTD.

## Condensed Consolidated Interim Statement of Changes in Equity

(Unaudited)

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

	Number of shares/units	Share capital	Share option reserve	Exchange fluctuation reserve	Accumulated deficit	Total
Balances, January 1, 2017	257,698	\$ 1,094,619	\$ 52,340	\$ (5,158)	\$ (1,095,788)	\$ 46,013
Shares issued for:						
Interest settlement on convertible debenture	14,892	4,000	-	-	-	4,000
Employee share purchase plan	3	1	-	-	-	1
Share-based compensation credited to operations	-	-	67	-	-	67
Net loss for the period	-	-	-	-	(16,530)	(16,530)
Exchange differences on translation of foreign operations	-	-	-	943	-	943
Balances, June 30, 2017	272,593	\$ 1,098,620	\$ 52,407	\$ (4,215)	\$ (1,112,318)	\$ 34,494
<b>Balances, January 1, 2018</b>	<b>272,607</b>	<b>\$ 1,098,623</b>	<b>\$ 52,463</b>	<b>\$ (4,737)</b>	<b>\$ (1,135,809)</b>	<b>\$ 10,540</b>
Change in accounting policy due to IFRS 9	-	-	-	-	(1,332)	(1,332)
<b>Restated balances, January 1, 2018</b>	<b>272,607</b>	<b>\$ 1,098,623</b>	<b>\$ 52,463</b>	<b>\$ (4,737)</b>	<b>\$ (1,137,141)</b>	<b>\$ 9,208</b>
Shares issued for:						
Employee share purchase plan	41	6	-	-	-	6
Share-based compensation charged to operations	-	-	37	-	-	37
Net loss for the period	-	-	-	-	(30,063)	(30,063)
Exchange differences on translation of foreign operations	-	-	-	(2,430)	-	(2,430)
<b>Balances, June 30, 2018</b>	<b>272,648</b>	<b>\$ 1,098,629</b>	<b>\$ 52,500</b>	<b>\$ (7,167)</b>	<b>\$ (1,167,204)</b>	<b>\$ (23,242)</b>

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

**SOUTHGOBI RESOURCES LTD.**  
**Condensed Consolidated Interim Statement of Cash Flows**  
*(Unaudited)*  
*(Expressed in thousands of U.S. Dollars)*

	Notes	Six months ended June 30,	
		2018	2017
<b>Operating activities</b>			
Loss before tax		\$ (27,525)	\$ (13,771)
Adjustments for:			
Depreciation and depletion		10,178	16,982
Share-based compensation	21	37	67
Finance costs	8	11,932	11,169
Finance income	8	(366)	(14)
Share of earnings of a joint venture	15	(968)	(654)
Interest paid		(857)	(9,621)
Income tax paid		(2,022)	(347)
Unrealized foreign exchange loss/(gain)	7	(37)	576
Penalty on late settlement of trade payables	5	427	280
Loss on disposal of fixed assets	5	28	-
Provision for doubtful trade and other receivables	11	9,279	1,335
Provision for doubtful notes receivables	12	7,705	-
Provision for commercial arbitration	17	454	-
Provision for prepaid expenses and deposits	7	532	-
Impairment of properties for resale		-	1,075
Impairment of inventories	13	-	5,201
Operating cash flows before changes in non-cash working capital items		8,797	12,278
Net change in non-cash working capital items	24	4,399	(1,961)
<b>Cash generated from operating activities</b>		<b>13,196</b>	<b>10,317</b>
<b>Investing activities</b>			
Expenditures on property, plant and equipment		(20,656)	(7,280)
Proceeds from disposal of property, plant and equipment		320	-
Interest received		18	14
Dividend from a joint venture	15	1,148	1,071
<b>Cash used in investing activities</b>		<b>(19,170)</b>	<b>(6,195)</b>
<b>Financing activities</b>			
Proceeds from issuance of common shares		6	1
New loans		500	300
Repayment of interest-bearing loans		(744)	(4,287)
<b>Cash used in financing activities</b>		<b>(238)</b>	<b>(3,986)</b>
Effect of foreign exchange rate changes on cash and cash equivalents		209	32
<b>Increase/(decrease) in cash and cash equivalents</b>		<b>(6,003)</b>	<b>168</b>
Cash and cash equivalents, beginning of period		6,471	966
<b>Cash and cash equivalents, end of period</b>		<b>\$ 468</b>	<b>\$ 1,134</b>

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

# **SOUTHGOBI RESOURCES LTD.**

## **Notes to the Condensed Consolidated Interim Financial Statements**

*(Unaudited)*

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

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### **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. As of June 30, 2018, Land Breeze II S.a.r.l., a wholly-owned subsidiary of China Investment Corporation ("CIC") owned approximately 23.8% of the outstanding common shares of the Company. Novel Sunrise Investments Limited ("Novel Sunrise"), a wholly-owned subsidiary of China Cinda (HK) Investments Management Company Limited ("Cinda"), and Voyage Wisdom Limited each owned approximately 17.0% and 9.5% of the outstanding common shares of the Company, respectively.

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

The registered and records office of the Company is located at 20<sup>th</sup> Floor, 250 Howe Street, Vancouver, British Columbia, Canada, V6C 3R8. The head office and principal place of business of the Company is located at 1150 – 355 Burrard Street, Vancouver, British Columbia, Canada, V6C 2G8.

#### **Going concern assumption**

The Company's condensed consolidated interim financial statements have been prepared on a going concern basis which assumes that the Company will continue operating until at least June 30, 2019 and will be able to realize its assets and discharge its liabilities in the normal course of operations as they come due. However, in order to continue as a going concern, the Company must generate sufficient operating cash flows, secure additional capital or otherwise pursue a strategic restructuring, refinancing or other transactions to provide it with additional liquidity.

Several adverse conditions and material uncertainties cast significant doubt upon the going concern assumption. The Company had a working capital deficiency (excess current liabilities over current assets) of \$202,902 as at June 30, 2018 compared to \$166,321 of working capital deficiency as at December 31, 2017. Included in the working capital deficiency at June 30, 2018 are significant obligations, which include the obligation to pay CIC under the deferral agreement dated June 12, 2017 (the "June 2017 Deferral Agreement") in which the Company was required to pay \$9,731 of cash interest and associated costs on November 19, 2017 (the "June 2017 Deferral Agreement Payment"). In addition, pursuant to the terms of CIC Convertible Debenture, the Company was required to pay \$8,066 and \$7,934 of anniversary cash interest on November 19, 2017 and May 19, 2018, respectively, (the "Anniversary Interest Payments" and together with the June 2017 Deferral Agreement Payment, the "November 19<sup>th</sup> and May 19<sup>th</sup> Payments"). The Company is in discussion with CIC for a deferral of the November 19<sup>th</sup> and May 19<sup>th</sup> Payments; however, there can be no assurance that a favorable outcome will be reached. Accordingly the principal amount outstanding and all accrued and unpaid interest and other amounts owing under the CIC Convertible Debenture and the June 2017 Deferral Agreement would immediately become due and payable in the event that CIC provides notice to the Company.

# SOUTHGOBI RESOURCES LTD.

## Notes to the Condensed Consolidated Interim Financial Statements

(Unaudited)

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

### 1. CORPORATE INFORMATION AND GOING CONCERN (CONTINUED)

Pursuant to a confidential partial award (final except as to costs) (“Arbitration Award”) with respect to an the commercial arbitration on January 10, 2018 involving SouthGobi Sands LLC (“SGS”), a subsidiary of the Company, and First Concept Industrial Group Limited (“First Concept”), SGS has been ordered to repay the sum of \$11,500 to First Concept, together with accrued interest at a simple interest rate of 6% per annum from the date which the prepayment was made until the date of the Arbitration Award, and then at a simple interest rate of 8% per annum until full payment. On March 23, 2018, SGS received a notice from First Concept demanding payment of the full amount of the Arbitration Award, together with the accrued interest thereon, by no later than March 30, 2018, otherwise First Concept intends to commence enforcement proceedings against SGS in respect of the Arbitration Award. On May 10, 2018, SGS received a notice from First Concept advising that First Concept has obtained a court order dated April 27, 2018 from the High Court of Hong Kong granting leave to First Concept to enforce the Arbitration Award against SGS in Hong Kong. The Company is consulting with its independent litigation counsel regarding this matter. However, as SGS does not have any material assets, properties or place of business in Hong Kong, the Company is of the view that this court order will have little or no immediate impact on its ongoing operations. In the event that First Concept applies to enforce the Arbitration Award against SGS through judicial measures in courts of Mongolia or any other jurisdiction in which SGS has assets or properties, the Company intends to take appropriate steps to respond to such enforcement proceedings in the best interests of the Company through independent litigation counsel which has been retained by the Company for this purpose. If First Concept is successful in enforcing the Arbitration Award, the Company may not be able to re-pay the sum of \$11,500 and the associated interest. In such case, this will represent another event of default under the CIC Convertible Debenture and CIC would have another basis to declare the full principal and accrued interest owing thereunder immediately due and payable. Such an event of default under the CIC Convertible Debenture or the Company’s inability to re-pay the sum of \$11,500 and associated interest to First Concept could result in voluntary or involuntary proceedings involving the Company (including bankruptcy).

The Company also has other current liabilities, which require settlement in the short-term, including: the \$1,318 undiscounted balance of the Turquoise Hill Resources Limited (“Turquoise Hill”) loan (“TRQ Loan”) and the principal amount of equipment loan of \$2,279 and interest due in August 2018; and \$18,942 of unpaid taxes payable by SGS to the Mongolian government.

Further, the trade and other payables of the Company continue to accumulate due to liquidity constraints. The aging profile of the trade and other payables has worsened as compared to that as at December 31, 2017, as follows:

	As at	
	June 30, 2018	December 31, 2017
Less than 1 month	\$ 17,993	\$ 20,664
1 to 3 months	15,770	16,132
3 to 6 months	12,939	8,825
Over 6 months	39,952	33,598
<b>Total trade and other payables</b>	<b>\$ 86,654</b>	<b>\$ 79,219</b>



# **SOUTHGOBI RESOURCES LTD.**

## **Notes to the Condensed Consolidated Interim Financial Statements**

*(Unaudited)*

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

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### **1. CORPORATE INFORMATION AND GOING CONCERN (CONTINUED)**

The Company may not be able to settle all trade and other payables on a timely basis, while continuing postponement in settling the trade payables may impact the mining operations of the Company and result in potential lawsuits and/or bankruptcy proceedings being filed against the Company. No such lawsuits or proceedings are pending as at August 14, 2018.

In the fourth quarter of 2016, the Company initiated a plan to change the existing product mix to higher value and higher margin outputs by washing certain grades of coal in order to produce more premium semi-soft coking coal and to initiate more processing of the lower grades of coal in order to reduce the ash content and improve the selling price and margins on its thermal coal product. The construction of the wash plant was substantially completed in 2017, however commencement of washing has been delayed to the fourth quarter of 2018.

The current mine plan incorporates the coal washing and processing systems and contemplates significantly higher volumes of production in order to complement the Company's new product mix and sales volume targets. Such plans will require a significant level of stripping activities over the next two years and certain capital expenditures to achieve the designed production outputs. Such expenditures and other working capital requirements will require the Company to seek additional financing in the form of finance leases, debt or equity.

There is no guarantee that the Company will be able to successfully execute the measures mentioned above and secure other sources of financing. If it fails to do so, or is unable to secure additional capital or otherwise restructure or refinance its business in order to address its cash requirements through June 30, 2019, then the Company is unlikely to have sufficient capital resources or cash flows from mining operations in order to satisfy its current ongoing obligations and future contractual commitments. This could result in adjustments to the amounts and classifications of assets and liabilities in the Company's consolidated financial statements and such adjustments could be material.

Unless the Company acquires additional sources of financing and/or funding in the short term, the ability of the Company to continue as a going concern is threatened. If the Company is unable to continue as a going concern, it may be forced to seek relief under applicable bankruptcy and insolvency legislation.

As of the date hereof, the Company is in default under the CIC Convertible Debenture and the TRQ Loan. Pursuant to the terms of the CIC Convertible Debenture, CIC may, in its discretion, provide notice to the Company and declare all principal, interest and other amounts owing under the CIC Convertible Debenture immediately due and payable, and take steps to enforce payment thereof. Pursuant to the terms of the TRQ Loan, all of the outstanding obligations under the TRQ Loan are immediately due and payable to Turquoise Hill as of the date hereof. As of the date hereof, the Company has received no indication from CIC of any intention to deliver a notice of default under the CIC Convertible Debenture or to accelerate the amounts outstanding under the CIC Convertible Debenture, and has not received any indication from Turquoise Hill of any intention to deliver a notice of default under the TRQ Loan.

Furthermore, continuing delay in securing additional financing could ultimately result in an event of default of the equipment loan, which if not cured within cure periods in accordance with the terms of equipment loan, may result in the principal amounts owing and all accrued and unpaid interest becoming immediately due and payable upon notice to the Company by the lender of the equipment loan.

# SOUTHGOBI RESOURCES LTD.

## Notes to the Condensed Consolidated Interim Financial Statements

(Unaudited)

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

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### 1. CORPORATE INFORMATION AND GOING CONCERN (CONTINUED)

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

As at June 30, 2018 and December 31, 2017, the Company was not subject to any externally imposed capital requirements.

### 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 ("IAS") 34 - "Interim Financial Reporting" using accounting policies in compliance with the International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") and Interpretations of the IFRS Interpretations Committee ("IFRIC").

The condensed consolidated interim financial statements of the Company for the six months ended June 30, 2018 were approved and authorized for issue by the Board of Directors of the Company on August 14, 2018.

#### 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 March 31, 2018 condensed consolidated interim financial statements. 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, 2017.

#### 2.3 Adoption of new and revised standards and interpretations

The following new IASB standard was adopted by the Company on January 1, 2018.

IFRS 9	Financial Instruments <sup>(i)</sup>
IFRS 15	Revenue from Contracts with Customers <sup>(i)</sup>

(i) Effective for annual periods beginning on or after January 1, 2018

# SOUTHGOBI RESOURCES LTD.

## Notes to the Condensed Consolidated Interim Financial Statements

(Unaudited)

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

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### 2. BASIS OF PREPARATION (CONTINUED)

**IFRS 9, Financial Instruments (“IFRS 9”)**, addresses the classification, measurement and derecognition of financial assets and financial liabilities, introduces new rules for hedge accounting and a new impairment model for financial assets. The Company adopted IFRS 9 on a retrospective basis without restating prior period comparatives.

IFRS 9 requires financial assets to be classified as measured at fair value through profit and loss (FVTPL), fair value through other comprehensive income/loss (FVTOCI), and those measured at amortized cost. As a result of the adoption of this standard, the Company has changed its accounting policy for financial assets. The change did not impact the carrying value of any financial assets on the transition date, January 1, 2018. The Company’s cash and trade and other receivables, and notes receivables, were reclassified from loans and receivable to amortized cost.

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

Additionally, the new impairment model requires the recognition of impairment provisions based on expected credit losses (“ECL”) rather than only incurred credit losses as is the case under IAS 39. It applies to financial assets classified at amortized cost. The ECL model requires judgement as to how changes in economic factors affect ECLs, which are determined on a probability-weighted basis. The Company applies the IFRS 9 simplified approach to measuring expected credit losses on its trade receivables and estimates expected credit loss based on the possible default events on its trade and other receivables within the next twelve months. The Company has determined that, due to the unsecured nature of its trade and other receivables and notes receivables, the loss allowance on its trade and other receivables and notes receivables increased by \$9,279 and \$7,705 during the period ended June 30, 2018, respectively, relating to an expected loss rate of 10% for trade and notes receivables 60 days past due and 100% for trade and notes receivables 180 days past due.

**IFRS 15, Revenue from Contracts with Customers (“IFRS 15”)**, deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, timing and uncertainty of revenue and cash flows arising from an entity’s contracts with customers. Revenue is recognized when a customer obtains control of a good or service and thus has the ability to direct the use and obtain the benefits from the good or service. The standard replaces IAS 18 *Revenue* and IAS 11 *Construction Contracts*, and related interpretations.

The Company has concluded there were no significant changes in the accounting for sales as a result of the transition to IFRS 15. The Company produces coal products and the relevant performance obligations relate primarily to the delivery of the coal products to customers, with each delivery representing a separate performance obligation.

# **SOUTHGOBI RESOURCES LTD.**

## **Notes to the Condensed Consolidated Interim Financial Statements**

*(Unaudited)*

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

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### **2. BASIS OF PREPARATION (CONTINUED)**

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

There have been no other new IFRSs or IFRIC interpretations that is not yet effective that would be expected to have a material impact on the Company, except those disclosed in the Company's annual consolidated financial statements for the year ended December 31, 2017.

#### **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 3.23 to the Company's December 31, 2017 consolidated annual financial statements. The significant accounting judgments and estimates remain substantially unchanged from December 31, 2017.

#### **Liquidity and the 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 as well as the expected timing of payments of suppliers and the repayment of debt and other financial liabilities. Refer to Note 1 for details.

#### **Review of carrying value of assets and impairment charges**

As of the date hereof, the Company is in default under the CIC Convertible Debenture and the TRQ Loan. Pursuant to the terms of the CIC Convertible Debenture, CIC may, in its discretion, provide notice to the Company and declare all principal, interest and other amounts owing under the CIC Convertible Debenture immediately due and payable, and take steps to enforce payment thereof. Pursuant to the terms of the TRQ Loan, all of the outstanding obligations under the TRQ Loan are immediately due and payable to Turquoise Hill as of the date hereof. As of the date hereof, the Company has received no indication from CIC of any intention to deliver a notice of default under the CIC Convertible Debenture or to accelerate the amounts outstanding under the CIC Convertible Debenture, and has not received any indication from Turquoise Hill of any intention to deliver a notice of default under the TRQ Loan.

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 equipment loan, which if not cured within applicable cure periods in accordance with the terms of such instruments, may result in the principal amounts owing and all accrued and unpaid interest becoming immediately due and payable upon notice to the lender of the equipment loan.

# **SOUTHGOBI RESOURCES LTD.**

## **Notes to the Condensed Consolidated Interim Financial Statements**

*(Unaudited)*

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

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### **2. BASIS OF PREPARATION (CONTINUED)**

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

#### ***Ovoot Tolgoi Mine cash generating unit***

The Company determined that an indicator of impairment existed for its Ovoot Tolgoi Mine cash generating unit as at June 30, 2018. The impairment indicator was the uncertainty of future coal prices in China.

Therefore, the Company conducted an impairment test whereby the carrying value of the Company's Ovoot Tolgoi Mine cash generating unit was compared to its "fair value less costs of disposal" ("FVLCTD") using a discounted future cash flow valuation model. The Company's cash flow valuation model takes into consideration the latest available information to the Company, including but not limited to, sales price, sales volumes, operating cost and life of mine coal production assumptions as at June 30, 2018. The Company's Ovoot Tolgoi Mine cash generating unit carrying value was \$78,217 as at June 30, 2018.

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

- Coal resources and reserves as estimated by an independent third party engineering firm;
- Sales price estimates from an independent market consulting firm;
- Forecasted sales volumes in line with production levels as per the updated mine plan;
- Life-of-mine coal production, strip ratio, capital costs and operating costs;
- Coal processing to increase the grade and qualities of the thermal coal produced and sold; and
- A post-tax discount rate of 12.9% based on an analysis of the market, country and asset specific factors.

The impairment analysis did not result in the identification of an impairment loss or an impairment reversal and no charge or reversal was required as at June 30, 2018. 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.

### **3. SEGMENTED INFORMATION**

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

During the six months ended June 30, 2018, the Coal Division had 16 active customers with the largest customer accounting for 20% of revenues, the second largest customer accounting for 15% of revenues, the third largest customer accounting for 12% of revenues and the other customers accounting for the remaining 53% of revenues.

# SOUTHGOBI RESOURCES LTD.

## Notes to the Condensed Consolidated Interim Financial Statements

(Unaudited)

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

### 3. SEGMENTED INFORMATION (CONTINUED)

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

	Coal Division	Unallocated (i)	Consolidated Total
<b>Segment assets</b>			
As at June 30, 2018	\$ 244,790	\$ 1,300	\$ 246,090
As at December 31, 2017	253,256	7,311	260,567
<b>Segment liabilities</b>			
As at June 30, 2018	\$ 125,393	\$ 143,939	\$ 269,332
As at December 31, 2017	119,095	130,932	250,027
<b>Segment revenues</b>			
For the three months ended June 30, 2018	\$ 17,377	\$ -	\$ 17,377
For the three months ended June 30, 2017	34,665	-	34,665
For the six months ended June 30, 2018	\$ 40,600	\$ -	\$ 40,600
For the six months ended June 30, 2017	59,919	-	59,919
<b>Segment profit/(loss)</b>			
For the three months ended June 30, 2018	\$ (25,300)	\$ (1,303)	\$ (26,603)
For the three months ended June 30, 2017	442	(7,355)	(6,913)
For the six months ended June 30, 2018	\$ (27,676)	\$ (2,387)	\$ (30,063)
For the six months ended June 30, 2017	(1,454)	(15,076)	(16,530)
<b>Impairment charge on assets</b> (ii) (iii)			
For the three months ended June 30, 2018	\$ 16,413	\$ -	\$ 16,413
For the three months ended June 30, 2017	5,280	-	5,280
For the six months ended June 30, 2018	\$ 17,516	\$ -	\$ 17,516
For the six months ended June 30, 2017	7,611	-	7,611
<b>Depreciation and amortization</b>			
For the three months ended June 30, 2018	\$ 9,547	\$ 16	\$ 9,563
For the three months ended June 30, 2017	12,095	73	12,168
For the six months ended June 30, 2018	\$ 19,188	\$ 41	\$ 19,229
For the six months ended June 30, 2017	23,729	143	23,872
<b>Share of earnings of a joint venture</b>			
For the three months ended June 30, 2018	\$ 628	\$ -	\$ 628
For the three months ended June 30, 2017	388	-	388
For the six months ended June 30, 2018	\$ 968	\$ -	\$ 968
For the six months ended June 30, 2017	654	-	654

# SOUTHGOBI RESOURCES LTD.

## Notes to the Condensed Consolidated Interim Financial Statements

(Unaudited)

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

### 3. SEGMENTED INFORMATION (CONTINUED)

	Coal Division	Unallocated (i)	Consolidated Total
<b>Finance cost</b>			
For the three months ended June 30, 2018	\$ 403	\$ 5,555	\$ 5,958
For the three months ended June 30, 2017	115	5,379	5,494
For the six months ended June 30, 2018	\$ 1,110	\$ 10,822	\$ 11,932
For the six months ended June 30, 2017	413	10,756	11,169
<b>Finance income</b>			
For the three months ended June 30, 2018	\$ 140	\$ -	\$ 140
For the three months ended June 30, 2017	10	40	50
For the six months ended June 30, 2018	\$ 308	\$ 58	\$ 366
For the six months ended June 30, 2017	14	-	14
<b>Current income tax</b>			
For the three months ended June 30, 2018	\$ 1,609	\$ -	\$ 1,609
For the three months ended June 30, 2017	2,714	-	2,714
For the six months ended June 30, 2018	\$ 2,538	\$ -	\$ 2,538
For the six months ended June 30, 2017	2,759	-	2,759

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

(ii) The impairment charges on assets for the three and six months ended June 30, 2018 relate to trade and other receivables (Note 11), notes receivables (Note 12) and prepaid expenses and deposits.

(iii) The impairment charge on assets for the three and six months ended June 30, 2017 related to trade and other receivables (Note 11), properties for resale and inventories (Note 13).

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

	Mongolia	Hong Kong	China	Consolidated Total
<b>Revenue (i)</b>				
For the three months ended June 30, 2018	\$ -	\$ -	\$ 17,377	\$ 17,377
For the three months ended June 30, 2017	-	-	34,665	34,665
For the six months ended June 30, 2018	\$ -	\$ -	\$ 40,600	\$ 40,600
For the six months ended June 30, 2017	-	-	59,919	59,919
<b>Non-current assets</b>				
As at June 30, 2018	\$ 184,486	\$ 196	\$ 420	\$ 185,102
As at December 31, 2017	181,603	467	345	182,415

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

### 4. REVENUE

Revenue represents the net invoiced value of goods sold which arises from the trading of coal.

# SOUTHGOBI RESOURCES LTD.

## Notes to the Condensed Consolidated Interim Financial Statements

(Unaudited)

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

### 5. EXPENSES BY NATURE

The Company's expenses by nature are summarized as follows:

	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Depreciation	\$ 8,672	\$ 9,690	\$ 15,091	\$ 20,538
Auditors' remuneration	179	172	290	274
Employee benefit expense (including directors' remuneration)				
Wages and salaries	\$ 1,507	\$ 2,144	\$ 2,748	\$ 4,050
Equity-settled share option expense (Note 21)	21	30	37	67
Pension scheme contributions	100	194	202	399
	\$ 1,628	\$ 2,368	\$ 2,987	\$ 4,516
Minimum lease payments under operating leases	\$ 303	\$ 203	\$ 459	\$ 406
Foreign exchange loss/(gain)	742	1,607	(37)	2,105
Impairment of coal stockpile inventories (Note 13)	-	2,870	-	5,201
Provision for doubtful trade and other receivables (Note 11)	8,176	1,335	9,279	1,335
Provision for doubtful notes receivables (Note 12)	7,705	-	7,705	-
Provision for prepaid expenses and deposits	532	-	532	-
Loss/(gain) on disposal of property, plant and equipment	(39)	-	28	-
Provision for commercial arbitration (Note 17)	230	-	454	-
Penalty on late settlement with trade payables	323	-	427	280
Mining services, net	-	-	-	2,395
Impairment of properties for resale	-	1,075	-	1,075
Mine operating costs and other	8,730	14,488	20,312	25,064
<b>Total expenses</b>	<b>\$ 37,181</b>	<b>\$ 33,808</b>	<b>\$ 57,527</b>	<b>\$ 63,189</b>

### 6. COST OF SALES

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

	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Operating expenses	\$ 6,445	\$ 14,891	\$ 16,577	\$ 25,591
Share-based compensation expense	-	5	-	28
Depreciation and depletion	4,853	7,454	7,694	14,940
Impairment of coal stockpile inventories	-	2,870	-	5,201
Cost of sales from mine operations	11,298	25,220	24,271	45,760
Cost of sales related to idled mine assets <sup>(i)</sup>	3,780	2,165	7,314	5,384
<b>Cost of sales</b>	<b>\$ 15,078</b>	<b>\$ 27,385</b>	<b>\$ 31,585</b>	<b>\$ 51,144</b>

(i) Cost of sales related to idled mine assets were all related to the depreciation expense for the Company's idled plant and equipment.

Cost of inventories recognized as expense in cost of sales for the three months ended June 30, 2018 totaled \$9,956 (2017: \$28,290). Cost of inventories recognized as expense in cost of sales for the six months ended June 30, 2018 totaled \$21,804 (2017: \$44,534).



# SOUTHGOBI RESOURCES LTD.

## Notes to the Condensed Consolidated Interim Financial Statements

(Unaudited)

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

### 7. OTHER OPERATING EXPENSES

The Company's other operating income/(expenses) consist of the following amounts:

	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Provision for doubtful notes receivables (Note 12)	\$ (7,705)	-	\$ (7,705)	-
Provision for doubtful trade and other receivables (Note 11)	(8,176)	(1,335)	(9,279)	(1,335)
Foreign exchange gain/(loss)	(742)	(1,607)	37	(2,105)
Provision for prepaid expenses and deposits	(532)	-	(532)	-
CIC management fee	(395)	-	(978)	-
Provision for commercial arbitration (Note 17)	(230)	-	(454)	-
Penalty on late settlement of trade payables	(323)	-	(427)	(280)
Gain/(loss) on disposal of property, plant and equipment (Note 14)	39	-	(28)	-
Impairment of properties for resale	-	(1,075)	-	(1,075)
Mining services, net	-	-	-	(2,395)
Others	(27)	(28)	(63)	(63)
<b>Other operating expenses</b>	<b>\$ (18,091)</b>	<b>\$ (4,045)</b>	<b>\$ (19,429)</b>	<b>\$ (7,253)</b>

### 8. FINANCE COSTS AND INCOME

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

	Three months ended, June 30,		Six months ended, June 30,	
	2018	2017	2018	2017
Interest expense on convertible debenture (Note 19)	\$ 5,516	\$ 5,330	\$ 10,810	\$ 10,607
Unrealized loss on embedded derivatives in convertible debenture (Note 19)	32	-	-	137
Interest expense on borrowings (Note 18)	358	125	1,011	268
Loan arrangement fee (Note 18)	6	-	19	81
Accretion of decommissioning liability	46	39	92	76
<b>Finance costs</b>	<b>\$ 5,958</b>	<b>\$ 5,494</b>	<b>\$ 11,932</b>	<b>\$ 11,169</b>

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

	Three months ended, June 30,		Six months ended, June 30,	
	2018	2017	2018	2017
Unrealized gain on embedded derivatives in convertible debenture (Note 19)	\$ -	\$ 40	\$ 58	\$ -
Interest income	8	10	18	14
Fair value gain on notes receivable upon redemption (Note 12)	132	-	290	-
<b>Finance income</b>	<b>\$ 140</b>	<b>\$ 50</b>	<b>\$ 366</b>	<b>\$ 14</b>

# SOUTHGOBI RESOURCES LTD.

## Notes to the Condensed Consolidated Interim Financial Statements

(Unaudited)

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

### 9. TAXES

The Canadian statutory tax rate was 26% (2017: 26%) on the estimated assessable profits arising in Canada during the period. Taxes on profits assessable elsewhere have been calculated at the rates of tax prevailing in the countries/jurisdictions in which the Company operates.

	Three months ended, June 30,		Six months ended, June 30,	
	2018	2017	2018	2017
Current - Canada				
Charge for the period	\$ -	\$ -	\$ -	\$ -
Current - elsewhere				
Charge for the period	1,348	2,714	2,277	2,759
Underprovision in prior periods	261	-	261	-
<b>Total tax charge for the period</b>	<b>\$ 1,609</b>	<b>\$ 2,714</b>	<b>\$ 2,538</b>	<b>\$ 2,759</b>

### 10. LOSS PER SHARE

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

	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Net loss	\$ (26,603)	\$ (6,913)	\$ (30,063)	\$ (16,530)
Weighted average number of shares	272,644	272,592	272,641	272,183
<b>Basic and diluted loss per share</b>	<b>\$ (0.10)</b>	<b>\$ (0.03)</b>	<b>\$ (0.11)</b>	<b>\$ (0.06)</b>

Potentially dilutive items not included in the calculation of diluted loss per share for the three and six months ended June 30, 2018 include the convertible debenture (Note 19) and stock options (Note 21) that were anti-dilutive.

### 11. TRADE AND OTHER RECEIVABLES

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

	As at	
	June 30, 2018	December 31, 2017
Trade receivables	\$ 7,665	\$ 12,901
Other receivables	4,350	3,585
<b>Total trade and other receivables</b>	<b>\$ 12,015</b>	<b>\$ 16,486</b>

# SOUTHGOBI RESOURCES LTD.

## Notes to the Condensed Consolidated Interim Financial Statements

(Unaudited)

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

### 11. TRADE AND OTHER RECEIVABLES (CONTINUED)

The aging of the Company's trade and other receivables, based on invoice date and net of provisions, is as follows:

	As at	
	June 30, 2018	December 31, 2017
Less than 1 month	\$ 4,405	\$ 15,962
1 to 3 months	245	296
3 to 6 months	7,365	19
Over 6 months	-	209
<b>Total trade and other receivables</b>	<b>\$ 12,015</b>	<b>\$ 16,486</b>

Trade receivables are normally paid within 6 months from the date of billing. Overdue balances are reviewed regularly by senior management. The Company does not hold any collateral or other credit enhancements over its trade and other receivable balances.

The Company made a provision of \$9,279 on its trade and other receivables for the six months ended June 30, 2018 (2017: \$1,335). As at June 30, 2018, the provision for doubtful trade and other receivables amounted to \$9,964 (December 31, 2017: \$697).

### 12. NOTES RECEIVABLES

Notes receivables are financial instruments in the Chinese banking system. As at June 30, 2018, bank notes receivables of \$76 (December 31, 2017: \$1,898) are readily convertible into cash or can be utilized as settlement of outstanding payables. As at December 31, 2017, commercial notes receivables of \$10,622 with maturity within 6 months were recorded. A provision for commercial notes receivables of \$7,705 was made during the three and six months ended June 30, 2018 (2017: nil) as the counterparty did not honor its obligations. Finance income of \$132 and \$290 was recorded for the commercial notes receivables during the three and six months ended June 30, 2018, respectively (2017: nil).

### 13. INVENTORIES

The Company's inventories consist of the following amounts:

	As at	
	June 30, 2018	December 31, 2017
Coal stockpiles	\$ 21,779	\$ 18,223
Materials and supplies	16,653	18,166
<b>Total inventories</b>	<b>\$ 38,432</b>	<b>\$ 36,389</b>

Cost of sales for the three months and six months ended June 30, 2017 includes an impairment loss of \$2,870 and \$5,201, respectively, related to the Company's coal stockpile inventories. Nil impairment was noted during three months and six months ended June 30, 2018.

# SOUTHGOBI RESOURCES LTD.

## Notes to the Condensed Consolidated Interim Financial Statements

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

### 14. PROPERTY, PLANT AND EQUIPMENT

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

	Mobile equipment	Other operating equipment	Buildings and roads	Mineral properties	Non- depreciable assets	Total
<b>Cost</b>						
As at January 1, 2018	\$ 350,540	\$ 28,874	\$ 72,194	\$ 173,401	\$ 28,967	\$ 653,976
Additions	1,061	411	-	26,025	230	27,727
Disposals	(1,023)	(78)	-	-	(1,962)	(3,063)
Exchange realignment	(5,344)	(204)	(825)	(2,000)	(17)	(8,390)
<b>As at June 30, 2018</b>	<b>\$ 345,234</b>	<b>\$ 29,003</b>	<b>\$ 71,369</b>	<b>\$ 197,426</b>	<b>\$ 27,218</b>	<b>\$ 670,250</b>
<b>Accumulated depreciation and impairment charges</b>						
As at January 1, 2018	\$ (297,264)	\$ (28,326)	\$ (51,443)	\$ (100,297)	\$ (24,189)	\$ (501,519)
Depreciation for the period	(15,710)	(140)	(2,356)	(1,023)	-	(19,229)
Eliminated on disposals	544	78	-	-	-	622
Exchange realignment	4,258	255	571	405	123	5,612
<b>As at June 30, 2018</b>	<b>\$ (308,172)</b>	<b>\$ (28,133)</b>	<b>\$ (53,228)</b>	<b>\$ (100,915)</b>	<b>\$ (24,066)</b>	<b>\$ (514,514)</b>
<b>Carrying amount</b>						
As at December 31, 2017	\$ 53,276	\$ 548	\$ 20,751	\$ 73,104	\$ 4,778	\$ 152,457
<b>As at June 30, 2018</b>	<b>\$ 37,062</b>	<b>\$ 870</b>	<b>\$ 18,141</b>	<b>\$ 96,511</b>	<b>\$ 3,152</b>	<b>\$ 155,736</b>

#### 14.1 Non-depreciable assets

The non-depreciable assets include the construction in progress and deposits on purchasing items of property, plant and equipment of \$2,180 (December 31, 2017: \$4,169), which primarily relate to ordered but not yet delivered mobile equipment or mobile equipment delivered to the location of its intended use but not yet commissioned.

#### 14.2 Pledge on items of property, plant and equipment

As at June 30, 2018, certain of the Company's property, plant and equipment of \$9,472 (December 31, 2017: \$4,539) were pledged as security for a bank loan granted to the Company (Note 18).

#### 14.3 Items of property, plant and equipment held under finance leases

As at June 30, 2018, certain of the Company's mobile equipment of \$229 (December 31, 2017: \$672) were held under finance leases.

# SOUTHGOBI RESOURCES LTD.

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### 15. INVESTMENT IN A JOINT VENTURE

The Company's investment consists of the following amounts:

	As at	
	June 30, 2018	December 31, 2017
<b>Non-current investment in joint venture</b>		
Investment in RDCC LLC	\$ 20,589	\$ 21,052
<b>Total investments</b>	<b>\$ 20,589</b>	<b>\$ 21,052</b>

The Company has a 40% interest in RDCC LLC, a joint venture. RDCC LLC has a concession agreement with the State Property Committee of Mongolia to construct a paved highway from the Company's Ovoot Tolgoi Mine to the Mongolia-China border for the exclusive use of third party coal transport companies. In October 2012, the concession agreement was structured as a 17-year build, operate and transfer agreement. The construction was completed in 2014 and operations commenced in the second quarter of 2015. On September 17, 2015, the Invest Mongolia Agency signed an amendment to the concession agreement with RDCC LLC to extend the exclusive right of ownership to 30 years.

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

	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Balance, beginning of period	\$ 21,142	\$ 21,438	\$ 21,052	\$ 21,335
Dividend received	(660)	(649)	(1,148)	(1,071)
Share of earnings of a joint venture	628	388	968	654
Share of other comprehensive income of a joint venture	(521)	684	(283)	943
<b>Balance, end of period</b>	<b>\$ 20,589</b>	<b>\$ 21,861</b>	<b>\$ 20,589</b>	<b>\$ 21,861</b>

For the three and six months ended June 30, 2018, RDCC LLC recognized toll fee revenue of \$2,503 and \$4,060, respectively (For the three and six months ended June 30, 2017: \$1,953 and \$3,134, respectively). For the three and six months ended June 30, 2018, RDCC LLC had a net income of \$1,570 and \$2,419, respectively (For the three and six months ended June 30, 2017: \$971 and \$1,635, respectively).

### 16. 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.

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### 16. TRADE AND OTHER PAYABLES (CONTINUED)

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

	As at	
	June 30, 2018	December 31, 2017
Less than 1 month	\$ 17,993	\$ 20,664
1 to 3 months	15,770	16,132
3 to 6 months	12,939	8,825
Over 6 months	39,952	33,598
<b>Total trade and other payables</b>	<b>\$ 86,654</b>	<b>\$ 79,219</b>

### 17. PROVISION FOR COMMERCIAL ARBITRATION

On June 24, 2015, First Concept served a notice of arbitration (the "Notice") on SGS in respect of a coal supply agreement dated May 19, 2014 as amended on June 27, 2014 (the "Coal Supply Agreement") for a total consideration of \$11,500.

On January 10, 2018, the Company received a confidential partial award (final except as to costs) with respect to the commercial arbitration. Pursuant to the Arbitration Award, SGS has been ordered to repay the sum of \$11,500 (which SGS had received as a prepayment for the purchase of coal) to First Concept, together with accrued interest at a simple interest rate of 6% per annum from the date which the prepayment was made until the date of the Arbitration Award, and then at a simple interest rate of 8% per annum until full payment. The Arbitration Award is final, except as to costs which have been reserved for a future award. As at June 30, 2018, the Company has recorded a provision of \$14,338 for the commercial arbitration. (December 31, 2017: \$13,884).

On March 23, 2018, SGS received a notice from First Concept demanding payment of the full amount of the Arbitration Award, together with the accrued interest thereon, by no later than March 30, 2018, otherwise First Concept intends to commence enforcement proceedings against SGS in respect of the Arbitration Award. On May 10, 2018, SGS received a notice from First Concept advising that First Concept has obtained a court order dated April 27, 2018 from the High Court of Hong Kong granting leave to First Concept to enforce the Arbitration Award against SGS in Hong Kong. The Company is consulting with its independent litigation counsel regarding this matter. However, as SGS does not have any material assets, properties or place of business in Hong Kong, the Company is of the view that this court order will have little or no immediate impact on its ongoing operations. On August 7, 2018, SGS received a letter from First Concept advising of the aggregate amount of costs and disbursements that First Concept claims it has incurred in connection with the arbitration proceeding. The Company is consulting with its independent litigation counsel regarding this matter.

The Company is currently considering and reviewing its options with respect to the Arbitration Award, including exploring ways to work with First Concept on payment arrangements that are practical to and are in best interests of both parties; however, there can be no assurance that a favorable outcome will be reached.

# SOUTHGOBI RESOURCES LTD.

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### 17. PROVISION FOR COMMERCIAL ARBITRATION (CONTINUED)

In the event that First Concept applies to enforce the Arbitration Award against SGS through judicial measures in courts of Mongolia or any other jurisdictions in which SGS has assets or properties, the Company intends to take appropriate steps to respond to such enforcement proceedings in the best interests of the Company through independent litigation counsel which has been retained by the Company for this purpose. However, due to the inherent uncertainties of litigation, it is not possible to predict whether the Company will be successful in defending itself against any such enforcement proceedings.

If First Concept is successful in enforcing the Arbitration Award against SGS, the Company may not be able to re-pay the sum of \$11,500 and the associated interest. In such case, this will represent another event of default under the CIC Convertible Debenture and CIC would have another basis to declare the full principal and accrued interest owing thereunder immediately due and payable. Such an event of default under the CIC Convertible Debenture or the Company's inability to re-pay the sum of \$11,500 and associated interest to First Concept could result in voluntary or involuntary proceedings involving the Company (including bankruptcy).

### 18. INTEREST-BEARING BORROWINGS

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

	As at	
	June 30, 2018	December 31, 2017
Turquoise Hill Loan Facility (i)	\$ 1,181	\$ 1,708
Equipment loan (ii)	2,544	2,441
Bank loan (iii)	3,542	3,041
Finance leases payable (iv)	158	503
<b>Total interest-bearing borrowings</b>	<b>\$ 7,425</b>	<b>\$ 7,693</b>

#### (i) Turquoise Hill Loan Facility

On May 25, 2014, the Company announced it obtained a loan from Turquoise Hill in the form of a \$10,000 revolving credit facility to meet its short term working capital requirements (the "TRQ Loan"). The key commercial terms of the facility were: an original maturity date of August 30, 2014 (subsequently extended as described below); an interest rate of one month US dollar LIBOR Rate in effect plus 11% per annum; a commitment fee of 35% of interest rate payable quarterly in arrears on undrawn principal amount of facility and a front end fee of \$100.

During 2014 and 2015, the due date of the TRQ Loan, was extended several times and the maximum amount of the facility was reduced to \$3,800.

On May 16, 2016, the Company and Turquoise Hill entered into a deferral agreement (the "May 2016 Deferral Agreement"), whereby Turquoise Hill agreed to a limited deferral of repayment of all remaining amounts and obligations owing under the TRQ Loan to December 29, 2017 in accordance with the schedule of repayments set out below:

# SOUTHGOBI RESOURCES LTD.

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(Unaudited)

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### 18. INTEREST-BEARING BORROWINGS (CONTINUED)

- The Company agreed to effect monthly repayments on the last business day of each month in an amount of (i) \$150 per month from May 2016 to April 2017; (ii) \$200 per month from May 2017 to December 2017; and (iii) the remaining balance on December 29, 2017 (the payments in (i), (ii) and (iii), the "Repayments"); and
- Interest shall continue to accrue on all outstanding obligations at the 12-month US dollar LIBOR rate.

As of the date hereof, the Company has not paid its October, November and December 2017 monthly payments and the accrued interest. Pursuant to the terms of the TRQ Loan and the May 2016 Deferral Agreement, the Company is, as of the date hereof, in default of its obligations under the TRQ Loan and the May 2016 Deferral Agreement as a result of the Company failing to make the Repayments in its entirety on or before the dates set out above. Consequently, all of the outstanding obligations under the TRQ Loan and the May 2016 Deferral Agreement are immediately due and payable to Turquoise Hill as of the date hereof. The Company is in discussion with TRQ for a deferral of the amounts outstanding under the TRQ Loan and the May 2016 Deferral Agreement; however, there can be no assurance that a favorable outcome will be reached.

As at June 30, 2018, the outstanding principal and accrued interest under this facility amounted to \$600 and \$718, respectively (at December 31, 2017, the outstanding principal and accrued interest under this facility amounted to \$1,000 and \$708, respectively). A fair value gain of \$137 was credited to accumulated deficit upon the adoption of IFRS 9 starting from January 1, 2018.

#### **(ii) Equipment Loan**

Inner Mongolia SouthGobi Energy Co., Ltd., a subsidiary of the Company executed a \$10,369 loan agreement on August 31, 2017 with Beijing Jin Rui Tian Chen Asset Management Co Ltd ("JRTC"). for the purpose of financing the purchase of mining equipment to increase the production capacity of the Company.

The key terms of the equipment loan are as follows:

- Principal amount of \$10,369;
- Maturity date set at 12 months from each drawdown (subsequently amended);
- Interest rate of 12% per annum and payable upon maturity; and
- The Company was to have provided a corporate guarantee to cover the principal and interest owed and certain items of property, plant and equipment were to have been pledged as security upon the completion of equipment purchase.

A loan arrangement fee of 1% of the loan principal drawn was charged and will be amortized throughout the loan term. For the period ended June 30, 2018, \$19 of loan arrangement fee was amortized (2017: nil). The Company believes the principal amount is capped at the amount drawn down to date and the related mining equipment has not been purchased as of the date hereof.

As at June 30, 2018, the outstanding principal and accrued interest for the equipment loan amounted to \$2,279 and \$265, respectively (at December 31, 2017, the outstanding principal and accrued interest for the equipment loan amounted to \$2,309 and \$132, respectively).



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### 18. INTEREST-BEARING BORROWINGS (CONTINUED)

On July 9, 2018, the Company and JRTC entered into a supplementary agreement with the key commercial terms of the Equipment Loan modified as follows:

- The Company agreed to repay the outstanding principal and accrued interest owing under the Equipment Loan in accordance with the following repayment schedule: (i) \$502 on July 9, 2018; (ii) \$658 on August 3, 2018 and (iii) \$1,448 to JRTC on November 3, 2018; and
- Penalty Interest, at a rate of 0.1% per day, will be applied on any delayed repayment.

The amounts due on July 9, 2018 and August 3, 2018 have been paid by the Company as of the date hereof.

#### **(iii) Bank Loan**

On May 6, 2016, SGS obtained a bank loan (the "Bank Loan") in the principal amount of \$2,000 from a Mongolian bank (the "Bank"). The principal terms of the Bank Loan include, among other things, an interest rate of 15.8% per annum, a maturity date of May 6, 2017 (subsequently extended as described below) and SGS being required to pledge certain of its mobile equipment in favour of the Bank as collateral for the Bank Loan.

On July 6, 2017, the Company and the Bank entered into a supplementary agreement with the key commercial terms of the Bank Loan modified as follows:

- Principal amount increased to \$3,000;
- \$2,300 of the principal amount matured on May 6, 2018 while the remaining balance of the principal amount of \$700 will mature on January 4, 2019;
- Interest rate of 15.8% per annum applies to the \$2,300 portion of the principal amount, while an interest rate of 15.0% per annum applies to the remaining \$700 portion of the principal amount; in each case, interest is payable monthly; and
- Certain items of property, plant and equipment were pledged as security (subsequently released upon repayment of loan principal of \$2,300).

\$2,300 of the loan principal was repaid to the Bank by the Company in May 2018.

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

- Principal amount of the loan (the "2018 Bank Loan") of \$2,800;
- Maturity date set at 24 months from drawdown;
- Interest rate of 15% per annum and interest is payable monthly; and
- Certain items of property, plant and equipment with value of \$9,472 as at June 30, 2018 were pledged as security for both the Bank Loan and the 2018 Bank Loan.

As at June 30, 2018, the outstanding balance for the Bank Loan together with the 2018 Bank Loan was \$3,500 (December 31, 2017: \$3,000) and the Company owed accrued interest of \$42 (December 31, 2017: \$41).

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### 18. INTEREST-BEARING BORROWINGS (CONTINUED)

#### (iv) Finance Leases Payable

The Company leases certain of its mobile equipment for daily operations. These leases are classified as finance leases and have remaining lease terms ranging from 2 to 5 years.

At June 30, 2018, the total future minimum lease payments under finance leases and their present values were as follows:

	Minimum lease payments As at		Present value of minimum lease payments As at	
	June 30, 2018	December 31, 2017	June 30, 2018	December 31, 2017
Amounts payable:				
Within one year	\$ 107	\$ 192	\$ 94	\$ 162
In the second year	54	174	51	160
In the third to fifth years, inclusive	13	188	13	181
Total minimum finance lease payments	\$ 174	\$ 554	\$ 158	\$ 503
Future finance charges	(16)	(51)		
<b>Total net lease finance payables</b>	<b>\$ 158</b>	<b>\$ 503</b>		
<b>Portion classified as current liabilities</b>	<b>(94)</b>	<b>(162)</b>		
<b>Non-current portion</b>	<b>\$ 64</b>	<b>\$ 341</b>		

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### 19. CONVERTIBLE DEBENTURE

#### 19.1 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. During 2010, the Company exercised a right within the debenture to call and convert \$250,000 of the debenture for 21,471 Common Shares. Following the conversion the outstanding principal balance was \$250,000 and has remained unchanged at that balance to June 30, 2018.

#### 19.2 Debt host and embedded derivatives

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

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

#### 19.3 Valuation assumptions

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

	As at	
	June 30, 2018	December 31, 2017
Floor conversion price	<b>CAD\$8.88</b>	CAD\$8.88
Ceiling conversion price	<b>CAD\$11.88</b>	CAD\$11.88
Common share price	<b>CAD\$0.16</b>	CAD\$0.18
Historical volatility	<b>82%</b>	82%
Risk free rate of return	<b>2.20%</b>	2.22%
Foreign exchange spot rate (CAD\$ to U.S. Dollar)	<b>0.76</b>	0.80
Forward foreign exchange rate curve (CAD\$ to U.S. Dollar)	<b>0.76 - 0.78</b>	0.795 - 0.802

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### 19. CONVERTIBLE DEBENTURE (CONTINUED)

#### 19.4 Presentation

Based on the Company's valuation as at June 30, 2018, the fair value of the embedded derivatives decreased by \$58 compared to that at December 31, 2017 and increased by \$32 compared to that at March 31, 2018. The changes in fair value were recorded as finance income and finance expense for the three and six months ended June 30, 2018, respectively.

For the three months ended June 30, 2018, the Company recorded interest expense of \$5,516 related to the convertible debenture as a finance cost (2017: \$5,330). For the six months ended June 30, 2018, the Company recorded interest expense of \$10,810 related to the convertible debenture as a finance cost (2017: \$10,607). 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 June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Balance, beginning of period	\$ 123,047	\$ 115,204	\$ 116,374	\$ 117,590
Interest expense on convertible debenture	5,516	5,330	10,810	10,607
Increase/(decrease) in fair value of embedded derivatives	32	(40)	(58)	137
Fair value adjustment upon adoption of IFRS 9	-	-	1,469	-
Interest paid	-	(5,425)	-	(13,265)
<b>Balance, end of period</b>	<b>\$ 128,595</b>	<b>\$ 115,069</b>	<b>\$ 128,595</b>	<b>\$ 115,069</b>

The convertible debenture balance consists of the following amounts:

	As at	
	June 30, 2018	December 31, 2017
<b>Current convertible debenture</b>		
Interest payable	\$ 34,892	\$ 24,242
Debt host	93,359	91,730
Fair value of embedded derivatives	344	402
<b>Total convertible debenture</b>	<b>\$ 128,595</b>	<b>\$ 116,374</b>

# SOUTHGOBI RESOURCES LTD.

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(Unaudited)

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

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### 19. CONVERTIBLE DEBENTURE (CONTINUED)

#### 19.5 Interest deferral and settlement

On June 12, 2017, the Company executed the June 2017 Deferral Agreement with CIC for a revised repayment schedule on the \$22,254 of cash interest and associated costs originally due on May 19, 2017 (the "May 2017 Interest Payable"). The key repayment terms of the June 2017 Deferral Agreement are: (i) the Company was required to repay on average \$2,170 of the cash interest and associated costs monthly during the period from May 2017 to October 2017; and (ii) the Company was required to repay \$9,731 of cash interest and associated costs on November 19, 2017. The Company will pay a deferral fee at a rate of 6.4% per annum in consideration for the deferral.

At any time before the May 2017 Interest Payable is fully repaid, the Company is required to consult with and obtain written consent from CIC prior to effecting a replacement or termination of either or both of its Chief Executive Officer and its Chief Financial Officer, otherwise this will constitute an event of default under the CIC Convertible Debenture, but CIC shall not withhold its consent if the Board proposes to replace either or both such officers with nominees selected by the Board, provided that the Board acted honestly and in good faith with a view to the best interests of the Company in the selection of the applicable replacements.

In addition, pursuant to the terms of the CIC Convertible Debenture, the Company was required to pay \$8,066 and \$7,934 of anniversary cash interest to CIC on November 19, 2017 and May 19, 2018, respectively. Pursuant to the Convertible Debenture, the Company was also obliged to issue \$4,000 worth of November 2017 PIK Interest shares to CIC on November 19, 2017.

As of the date hereof, the Company: (i) has neither paid the November 19<sup>th</sup> and May 19<sup>th</sup> Payments nor issued the November 2017 PIK Interest shares to CIC within the cure period provided for in the CIC Convertible Debenture; and (ii) has not agreed upon a repayment plan for such amounts with CIC. Consequently, the Company is in default under the CIC Convertible Debenture and the June 2017 Deferral Agreement. Pursuant to the terms of the CIC Convertible Debenture and the June 2017 Deferral Agreement, CIC may, in its discretion, provide notice to the Company and declare all principal, interest and other amounts owing under the CIC Convertible Debenture and the June 2017 Deferral Agreement immediately due and payable, and take steps to enforce payment thereof, which would have a material adverse effect on the business and operations of the Company and may negatively affect the price and volatility of the Common Shares and any investment in such shares could suffer a significant decline or total loss in value. As of the date hereof, the Company has received no indication from CIC of any intention to deliver a notice of default under the CIC Convertible Debenture and the June 2017 Deferral Agreement or to accelerate the amounts outstanding under the CIC Convertible Debenture and the June 2017 Deferral Agreement.

# **SOUTHGOBI RESOURCES LTD.**

## **Notes to the Condensed Consolidated Interim Financial Statements**

*(Unaudited)*

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

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### **19. CONVERTIBLE DEBENTURE (CONTINUED)**

The Company is in discussion with CIC for a deferral of the November 19<sup>th</sup> and May 19<sup>th</sup> Payments and the November 2017 PIK Interest; however, there can be no assurance that a favorable outcome will be reached.

CIC has notified the Company that it requires that the mutual co-operating agreement (the “Co-Operation Agreement”) dated November 19, 2009 between the Company and CIC be amended to revise the manner in which the amount of the service fee payable to CIC under the Co-Operation Agreement is calculated with retroactive effect; however, the Company has not entered into any formal agreement in respect of the Co-Operation Agreement as of the date hereof.

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 CIC Convertible Debenture, default on other indebtedness and certain adverse judgments.

As a consequence of the Company not entering into a deferral agreement with CIC as at June 30, 2018, IAS 1 requires the Company to classify the entire balance of the CIC Convertible Debenture as a current liability as at June 30, 2018, notwithstanding the fact that CIC has not indicated any intention to deliver notice of default or accelerate the maturity of the debenture. The Company anticipates that both the debt host and the fair value of the embedded derivative will be classified as a non-current liability upon the execution of a deferral agreement, unless a future event of default occurs under the terms of the CIC Convertible Debenture.

### **20. EQUITY**

#### **20.1 Share Capital**

The Company has authorized an unlimited number of common and preferred shares with no par value. At June 30, 2018, the Company had 272,649 common shares outstanding (December 31, 2017: 272,607) and no preferred shares outstanding (December 31, 2017: nil).

#### **20.2 Accumulated deficit and dividends**

As at June 30, 2018, the Company has accumulated a deficit of \$1,167,204 (December 31, 2017: \$1,135,809). No dividends have been paid or declared by the Company since inception.

# SOUTHGOBI RESOURCES LTD.

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### 21. SHARE-BASED PAYMENTS

#### 21.1 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.

The Company did not grant any stock options to officers, employees, directors and other eligible persons for the six months ended June 30, 2018. For the six months ended June 30, 2017, the Company granted 100 stock options to a director at an exercise price of CAD\$0.39 and an expiry date of June 5, 2022 and granted 650 stock options to directors at an exercise price of CAD\$0.33 and an expiry date of June 30, 2022. The weighted average fair value of the options granted in the six months ended June 30, 2017 was estimated at \$0.08 (CAD\$0.11) per option at the grant date using the Black-Scholes option pricing model.

The total share-based compensation expenses for the three months ended June 30, 2018 was \$21 (2017: \$30). Share-based compensation expenses of \$21 (2017: \$24) has been allocated to administration expenses, nil share-based compensation expenses has been allocated to cost of sales and evaluation and exploration expenses (2017: \$5 and \$1, respectively).

The total share-based compensation expenses for the six months ended June 30, 2018 was \$37 (2017: \$67). Share-based compensation expenses of \$37 (2017: \$35) has been allocated to administration expenses, nil share-based compensation expenses has been allocated to cost of sales and evaluation and exploration expenses (2017: \$28 and \$4, respectively).

#### 21.2 Outstanding stock options

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

	Six months ended June 30, 2018		Six months ended June 30, 2017	
	Number of options	Weighted average exercise price (CAD\$)	Number of options	Weighted average exercise price (CAD\$)
Balance, beginning of period	2,290	\$ 0.38	1,910	\$ 0.61
Options granted	-	-	750	0.34
Options forfeited	-	-	(3)	0.92
Options expired	(350)	0.30	(330)	1.54
<b>Balance, end of period</b>	<b>1,940</b>	<b>\$ 0.38</b>	<b>2,327</b>	<b>\$ 0.39</b>

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### 21. SHARE-BASED PAYMENTS (CONTINUED)

The stock options outstanding and exercisable as at June 30, 2018 are as follows:

Exercise price (CAD\$)	Options Outstanding			Options Exercisable		
	Options outstanding	Weighted average exercise price (CAD\$)	Weighted average remaining contractual life (years)	Options outstanding and exercisable	Weighted average exercise price (CAD\$)	Weighted average remaining contractual life (years)
0.25 to 0.58	1,774	\$ 0.33	3.35	1,524	\$ 0.32	3.35
0.65 to 0.92	166	0.91	1.70	166	0.91	1.70
	<b>1,940</b>	<b>\$ 0.38</b>	<b>3.21</b>	<b>1,690</b>	<b>\$ 0.38</b>	<b>3.18</b>

### 22. RELATED PARTY TRANSACTIONS

In addition to the transactions detailed elsewhere in profit or loss, the Company had related party transactions with the following company related by way of directors or shareholders in common during the three and six months ended June 30, 2018:

- CIC – CIC is a major shareholder of the Company, CIC holds approximately 23.75% of the issued and outstanding common shares of the Company as at June 30, 2018. A co-operation agreement was signed on November 19, 2009 between the Company and CIC, in which an amount of service fee calculated based on 2.5% of the revenue of SGS shall be paid to CIC on a quarterly basis. During the three and six months ended June 30, 2018, \$395 and \$978 was recorded in profit or loss, respectively (three and six months ended June 30, 2017: \$681 and \$1,212, respectively).

Furthermore, the Company is in discussions with CIC for a further deferral of the November 19<sup>th</sup> and May 19<sup>th</sup> Payments and the November 2017 PIK Interest; however, there can be no assurance that a favorable outcome will be reached. As part of these discussions, CIC has notified the Company that, as a condition to agreeing to any deferral, it requires that the Co-Operation Agreement between the Company and CIC be amended to revise the manner in which the amount of the service fee payable to CIC under the Co-Operation Agreement is calculated with retroactive effect; however, the Company has not entered into any formal agreement in respect of the Co-Operation Agreement as of the date hereof.

#### 22.1 Related party expenses

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

	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Finance costs	\$ 5,516	\$ 5,331	\$ 10,810	\$ 10,607
Management fee	395	681	978	1,212
<b>Related party expenses</b>	<b>\$ 5,911</b>	<b>\$ 6,012</b>	<b>\$ 11,788</b>	<b>\$ 11,819</b>



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### 23. 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, except for the fair values of trade and other payables, interest bearing borrowings, and provision for commercial arbitration and convertible debenture below their respective carrying amounts given the several adverse conditions and material uncertainties that cast significant doubt upon the going concern assumption.

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.

Recurring measurements	As at June 30, 2018			
	Level 1	Level 2	Level 3	Total
<b>Financial liabilities measured at fair value</b>				
Convertible debenture - embedded derivatives	\$ -	\$ 344	\$ -	\$ 344
<b>Total financial liabilities measured at fair value</b>	<b>\$ -</b>	<b>\$ 344</b>	<b>\$ -</b>	<b>\$ 344</b>

Financial liabilities disclosed at fair value	As at June 30, 2018			
	Level 1	Level 2	Level 3	Total
Convertible debenture - debt host	-	202,168	-	202,168
<b>Total financial liabilities disclosed at fair value</b>	<b>\$ -</b>	<b>\$ 202,168</b>	<b>\$ -</b>	<b>\$ 202,168</b>

Recurring measurements	As at December 31, 2017			
	Level 1	Level 2	Level 3	Total
<b>Financial liabilities measured at fair value</b>				
Convertible debenture - embedded derivatives	\$ -	\$ 402	\$ -	\$ 402
<b>Total financial liabilities measured at fair value</b>	<b>\$ -</b>	<b>\$ 402</b>	<b>\$ -</b>	<b>\$ 402</b>

Financial liabilities disclosed at fair value	As at December 31, 2017			
	Level 1	Level 2	Level 3	Total
Convertible debenture - debt host	-	216,154	-	216,154
<b>Total financial liabilities disclosed at fair value</b>	<b>\$ -</b>	<b>\$ 216,154</b>	<b>\$ -</b>	<b>\$ 216,154</b>

There were no transfers between Level 1, 2 and 3 for the three and six months ended June 30, 2018.

# SOUTHGOBI RESOURCES LTD.

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### 24. SUPPLEMENTAL CASH FLOW INFORMATION

#### 24.1 Non-cash financing and investing activities

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

	Six months ended June 30,	
	2018	2017
Addition to decommissioning liability	\$ 73	\$ 375
Amortization of deferred stripping being capitalized	7,148	2,077
Proceed from disposal of fixed asset offset against payable	2,090	-
Trade receivables offset by deferred revenue	2,553	-
Notes receivables offset by deferred revenue	3,020	-
Convertible debenture interest settlement in shares (Note 19)	-	4,000
Trade receivables settled by properties for sale	-	10,752
Settlement of court case penalty via provision of mining services	-	6,184
Purchase of vehicles financed by loans	-	100
<b>Total non-cash financing and investing activities</b>	<b>\$ 14,884</b>	<b>\$ 23,488</b>

#### 24.2 Net change in non-cash working capital items

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

	Six months ended June 30,	
	2018	2017
Increase in inventories	\$ (1,020)	\$ (7,937)
Increase in trade and other receivables and notes receivables	(6,035)	(13,718)
Increase in prepaid expenses and deposits	(4,036)	(2,107)
Increase in trade and other payables	10,620	25,425
Increase/(decrease) in deferred revenue	4,870	(3,624)
<b>Net change in non-cash working capital items</b>	<b>\$ 4,399</b>	<b>\$ (1,961)</b>

# SOUTHGOBI RESOURCES LTD.

## Notes to the Condensed Consolidated Interim Financial Statements

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

### 25. COMMITMENTS FOR EXPENDITURE

As at June 30, 2018, the Company's commitments for expenditure that have not been disclosed elsewhere in the condensed consolidated financial statements are as follows:

	Within 1 year	2-3 years	Over 3 years	Total
<b>As at June 30, 2018</b>				
Capital expenditure commitments	\$ 5,362	\$ -	\$ -	\$ 5,362
Operating expenditure commitments	23,368	1,236	2,007	26,611
<b>Commitments</b>	<b>\$ 28,730</b>	<b>\$ 1,236</b>	<b>\$ 2,007</b>	<b>\$ 31,973</b>
<b>As at December 31, 2017</b>				
Capital expenditure commitments	\$ 4,363	\$ -	\$ -	\$ 4,363
Operating expenditure commitments	3,422	622	2,350	6,394
<b>Commitments</b>	<b>\$ 7,785</b>	<b>\$ 622</b>	<b>\$ 2,350</b>	<b>\$ 10,757</b>

### 26. CONTINGENCIES

#### 26.1 Class action lawsuit

In January 2014, Siskinds LLP, a Canadian law firm, filed a class action (the "Class Action") against the Company, certain of its former senior officers and directors, and its former auditors, Deloitte LLP, in the Ontario Court in relation to the Company's restatement of certain financial statements previously disclosed in the Company's public filings (the "Restatement").

To commence and proceed with the Class Action, the plaintiff was required to bring a preliminary leave motion and to certify the Class Action as a class proceeding (the "Leave Motion"). The Ontario Court rendered its decision on the Leave Motion on November 5, 2015 and dismissed the plaintiff's Leave Motion as against each of the former senior officers and directors of the Company named in the Class Action on the basis that the "large volume of compelling evidence" proved the defense of reasonable investigation on the balance of probabilities and provided the basis for dismissing the Leave Motion as against them.

However, the Ontario Court allowed the Class Action to proceed under Part XXIII.1 of the Ontario Securities Act, permitting the plaintiff to commence and proceed with an action against the Company in respect of alleged misrepresentations affecting trades in the secondary market for the Company's securities arising from the Restatement. The Company appealed this portion of the decision of the Ontario Court (the "Corporation Appeal").

The plaintiff appealed that part of the November 5, 2015 Ontario Court decision dismissing the action against former officers and directors of the Company (the "Individual's Appeal"). The Individual's Appeal was brought as of right to the Ontario Court of Appeal.

# **SOUTHGOBI RESOURCES LTD.**

## **Notes to the Condensed Consolidated Interim Financial Statements**

*(Unaudited)*

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### **26. CONTINGENCIES (CONTINUED)**

On September 18, 2017, the Ontario Court of Appeal dismissed the Corporation Appeal of the original Ontario lower court decision to permit the plaintiff to commence and proceed with the Class Action. Concurrently, the Ontario Court of Appeal allowed the Individual's Appeal of the original Ontario lower court decision to dismiss the plaintiff's leave motion against certain of the Company's former officers and directors and made an order granting leave for the plaintiff to proceed against such former officers and directors of the Company in relation to the Restatement. As a result, the plaintiff is now permitted to proceed with the Class Action against both the Company and the former officers and directors.

The Company filed an application for leave to appeal to the Supreme Court of Canada in November 2017. The leave to appeal to the Supreme Court of Canada was dismissed in June 2018.

Counsel for the parties are appearing in a case conference before the motions judge on September 3, 2018 to fix the process and timing leading up to the trial of the action, which trial date has not yet been fixed.

The Company firmly believes that it has a strong defense on the merits and will continue to vigorously defend itself against the Class Action through independent Canadian litigation counsel retained by the Company for this purpose. Due to the inherent uncertainties of litigation, it is not possible to predict the final outcome of the Class Action or determine the amount of potential losses, if any. However, the Company has judged a provision for this matter as at June 30, 2018 was not required.

#### **26.2 Toll wash plant agreement with Ejin Jinda**

In 2011, the Company entered into an agreement with Ejin Jinda, a subsidiary of China Mongolia Coal Co. Ltd. to toll-wash 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.

Under the original agreement with Ejin Jinda, which required the commercial operation of the wet washing facility to commence on October 1, 2011, the additional fees payable by the Company under the wet washing contract would have been \$18,500. At each reporting date, the Company assesses the agreement with Ejin Jinda and has determined it is not probable that these \$18,500 will be required to be paid. Accordingly, the Company has determined a provision for this matter as at June 30, 2018 is not required.

# **SOUTHGOBI RESOURCES LTD.**

## **Notes to the Condensed Consolidated Interim Financial Statements**

*(Unaudited)*

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

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### **26. CONTINGENCIES (CONTINUED)**

#### **26.3 Tax legislation**

Mongolian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Company may be challenged by the relevant authorities. The Mongolian tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged by tax authorities. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for five calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods. The Mongolian tax legislation does not provide definitive guidance in certain areas, specifically in areas such as VAT, withholding tax, corporate income tax, personal income tax, transfer pricing and other areas. From time to time, the Company adopts interpretations of such uncertain areas that reduce the overall tax rate of the Company. As noted above, such tax positions may come under heightened scrutiny as a result of recent developments in administrative and court practices. The impact of any challenge by the tax authorities cannot be reliably estimated; however, it may be significant to the financial position and/or the overall operations of the entity.

Management believes that its interpretation of the relevant legislation is appropriate and the Company's positions related to tax and other legislation will be sustained. Management believes that tax and legal risks are remote at present. The management performs regular re-assessment of tax risk and its position may change in the future as a result of the change in conditions that cannot be anticipated with sufficient certainty at present. As of June 30, 2018, management has assessed that recognition of a provision for uncertain tax position is not necessary.

#### **26.4 Mongolian royalties**

During 2017, the Company has been ordered by the Mongolian tax authority to apply "reference price" determined by the Government of Mongolia as opposed to calculated sales price that derived based on the actual contract price. Although no official letter was received by the Company as of the date hereof, there can be no assurance that the Government of Mongolia will not disagree with the methodology employed by the Company in determining the calculated sales price and deem such price "non-market" under Mongolian tax law.

Management believes that its interpretation of the relevant legislation is appropriate and the Company's positions related to royalty will be sustained. As of June 30, 2018, recognition of a provision for addition Mongolian royalties is not necessary.

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### ADDITIONAL STOCK EXCHANGE INFORMATION

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

#### A1. FINANCIAL INSTRUMENTS

##### Cash

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

	As at	
	June 30, 2018	December 31, 2017
Denominated in U.S. Dollars	\$ 12	\$ 5,234
Denominated in Chinese Renminbi	193	802
Denominated in Mongolian Tugriks	137	164
Denominated in Canadian Dollars	14	39
Denominated in Hong Kong Dollars	112	232
<b>Cash</b>	<b>\$ 468</b>	<b>\$ 6,471</b>

##### Exposure to fluctuations in foreign exchange rates

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

	As at	
	June 30, 2018	December 31, 2017
Increase/ decrease in foreign exchange rate against US Dollar		
+5%	\$ (2,086)	\$ (2,457)
-5%	2,086	2,457

#### A2. COMPLIANCE WITH THE CODE ON CORPORATE GOVERNANCE PRACTICES

The Company has, throughout the six months ended June 30, 2018, applied the principles and complied with the requirements of its corporate governance practices as defined by the Board of Directors and all applicable statutory, regulatory and stock exchange listings standards.

# SOUTHGOBI RESOURCES LTD.

## Appendix to the Condensed Consolidated Interim Financial Statements

(Unaudited)

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### A3. COMPLIANCE WITH MODEL CODE

The Company has adopted policies regarding directors' securities transactions in its Corporate Disclosure, Confidentiality and Securities Trading policy on terms that are similar in all material respects to the terms set out in the Model Code of Appendix 10 of the rules governing the listing of securities on the Hong Kong Stock Exchange.

The Board of Directors confirms that all of the Directors of the Company have complied with the required policies in the Company's Corporate Disclosure, Confidentiality and Securities Trading policy throughout the six months ended June 30, 2018.

### A4. PURCHASE, SALE OR REDEEMPTION OF LISTED SECURITIES OF THE COMPANY

The Company did not redeem its listed securities, nor did the Company or any of its subsidiaries purchase or sell such securities during the six months ended June 30, 2018.

### A5. SUBSTANTIAL SHAREHOLDERS

As at June 30, 2018, the persons or corporations (not being a Director or chief executive of the Company) who had an interest or short position in the shares and underlying shares of the Company as recorded in the register of interests in shares required to be kept by the Company were as follows:

Name	Nature of interest	Shares held <sup>(a)(f)</sup>	Approximate & of issued shares <sup>(e)</sup>
Land Breeze II S.a.r.l. <sup>(b)</sup>	Beneficial	64,766,591	23.75%
Fullbloom Investment Corporation <sup>(b)</sup>	Interest of controlled corporation	64,766,591	23.75%
CIC <sup>(b)</sup>	Interest of controlled corporation	64,766,591	23.75%
Novel Sunrise <sup>(c)</sup>	Beneficial	46,358,978	
Hope Rosy Limited <sup>(c)</sup>	Interest of controlled corporation	46,358,978	17.00%
China Cinda (HK) Investments Management Company Limited <sup>(c)</sup>	Interest of controlled corporation	46,358,978	17.00%
China Cinda (HK) Holdings Company Limited <sup>(c)</sup>	Interest of controlled corporation	46,358,978	17.00%
China Cinda Asset Management Co., Ltd. <sup>(c)</sup>	Interest of controlled corporation	46,358,978	17.00%
The Ministry of Finance of the People's Republic of China ("MOF") <sup>(c)</sup>	Interest of controlled corporation	46,358,978	17.00%
Voyage Wisdom Limited <sup>(d)</sup>	Beneficial	25,768,162	9.45%

# SOUTHGOBI RESOURCES LTD.

## Appendix to the Condensed Consolidated Interim Financial Statements

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

### A5. SUBSTANTIAL SHAREHOLDERS (CONTINUED)

Notes:

- (a) The information as to the Shares beneficially owned or controlled or directed that is not within the knowledge of the Company, its Directors or its officers has been furnished by the applicable Shareholders or has been extracted from the public filings.
- (b) Land Breeze II S.a.r.l. is a wholly-owned subsidiary of Fullbloom Investment Corporation, which is wholly owned by CIC. Accordingly, Fullbloom Investment Corporation and CIC are deemed to be interested in shares held by Land Breeze II S.a.r.l. and CIC.
- (c) Novel Sunrise is a wholly-owned subsidiary of Hope Rosy Limited, which is a wholly-owned subsidiary of China Cinda (HK) Investments Management Company Limited. China Cinda (HK) Investments Management Company Limited is a wholly-owned subsidiary of China Cinda (HK) Holdings Company Limited, which is wholly owned by China Cinda Asset Management Co. Ltd. China Cinda Asset Management Co., Ltd. is partially owned by MOF. Accordingly, Hope Rosy Limited is deemed to be interested in shares held by Novel Sunrise; and each of China Cinda (HK) Investments Management Company Limited, China Cinda (HK) Holdings Company Limited, China Cinda Asset Management Co., Ltd. and MOF.
- (d) Messrs. Aminbuhe, Guo and Li, all former directors of the Company, are directors of Voyage Wisdom Limited, a private company which owned 9.45% interest in the Company as at June 30, 2018.
- (e) The percentage represents the total number of the Shares and the underlying Shares interested divided by the number of issued Shares as at June 30, 2018 (i.e. 272,648,738 Shares).
- (f) All interests stated above are long positions.

Other than as disclosed above, the Company has not been notified of any relevant interests or short positions in the issued share capital of the Company as at June 30, 2018.

### A6. DIRECTORS' INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

As at June 30, 2018, the interests of the Company's directors in the shares, underlying shares and debentures of the Company and its associated corporations were as follows:

Name of directors	Number of Shares interested				Number of underlying Shares interested		Percentage interest in the company <sup>(5)</sup>
	Directly beneficially owned	Through spouse or minor children	Through controlled company	Beneficiary of a trust	Directly beneficially owned <sup>(4)</sup>	Total <sup>(6)</sup>	
<b><u>Current Directors</u></b>							
Mao Sun	-	-	-	-	500,000	500,000	0.18%
Jin Lan Quan	-	-	-	-	400,000	400,000	0.15%
Yingbin lan He	-	-	-	-	250,000	250,000	0.09%
Wen Yao	-	-	-	-	-	-	-
Lan Cheng	-	-	-	-	-	-	-
Zhiwei Chen	-	-	-	-	-	-	-
Xiaoxiao Li	-	-	-	-	-	-	-
<b><u>Former Directors</u></b>							
Aminbuhe <sup>(1)</sup>	-	-	25,768,162	-	100,000	25,868,162	9.49%
Yulan Guo <sup>(2)</sup>	-	-	25,768,162	-	100,000	25,868,162	9.49%
Ningqiao Li <sup>(3)</sup>	-	-	25,768,162	-	100,000	25,868,162	9.49%
Zhu Liu	-	-	-	-	400,000	400,000	0.15%



# SOUTHGOBI RESOURCES LTD.

## Appendix to the Condensed Consolidated Interim Financial Statements

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

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### A6. DIRECTORS' INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES (CONTINUED)

Notes:

- (1) Mr. Aminbuhe is a director of and owns 45% of Voyage Wisdom Limited, a private company which owned a 9.45% interest in the Company as at June 30, 2018. .
- (2) Mr. Guo is a director of and owns 10% of Voyage Wisdom Limited, a private company which owned a 9.45% interest in the Company as at June 30, 2018.
- (3) Mr. Li is a director of and owns 45% of Voyage Wisdom Limited, a private company which owned a 9.45% interest in the Company as at June 30, 2018.
- (4) These interests represented the underlying Shares comprised in the share options granted by the Company.
- (5) The percentage represents the total number of the Shares and the underlying Shares interested divided by the number of issued Shares as at June 30, 2018 (i.e. 272,648,738 Shares).
- (6) All interests stated are long positions.

Other than the shareholdings disclosed in the preceding table, none of the Directors of the Company had any interests or short positions in any shares, underlying shares or debentures of the Company or any of its associated corporations as at June 30, 2018.

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### A7. SHARE OPTION PLAN

The particulars of the Company's share option plan are set out in Note 20 of the condensed consolidated interim financial statements. The following table discuss movements in the Company's share options during the six month ended June 30, 2018.

Name	Number of share options					At June 30, 2018	Date of grant of share options	Exercise period of share options	Exercise price (CAD\$ per share)
	At January 1, 2018	Granted during the period	Exercised during the period	Forfeited during the period	Expired during the period				
<b>Directors</b>									
Mao Sun	100,000	-	-	-	-	100,000	December 14, 2015	December 14, 2016 - December 14, 2020	0.29
	100,000	-	-	-	-	100,000	November 16, 2016	November 16, 2017 - November 16, 2021	0.33
	100,000	-	-	-	-	100,000	November 16, 2016	November 16, 2018 - November 16, 2021	0.33
	200,000	-	-	-	-	200,000	June 30, 2017	June 30, 2018 - June 30, 2022	0.33
	<b>500,000</b>	-	-	-	-	<b>500,000</b>			
Jin Lan Quan	100,000	-	-	-	-	100,000	December 14, 2015	December 14, 2016 - December 14, 2020	0.29
	75,000	-	-	-	-	75,000	November 16, 2016	November 16, 2017 - November 16, 2021	0.33
	75,000	-	-	-	-	75,000	November 16, 2016	November 16, 2018 - November 16, 2021	0.33
	150,000	-	-	-	-	150,000	June 30, 2017	June 30, 2018 - June 30, 2022	0.33
	<b>400,000</b>	-	-	-	-	<b>400,000</b>			
Yingbin lan He	100,000	-	-	-	-	100,000	June 5, 2017	June 5, 2018 - June 5, 2022	0.39
	150,000	-	-	-	-	150,000	June 30, 2017	June 30, 2018 - June 30, 2022	0.33
	<b>250,000</b>	-	-	-	-	<b>250,000</b>			
Wen Yao	-	-	-	-	-	-			
Lan Cheng	-	-	-	-	-	-			
Zhiwei Chen	-	-	-	-	-	-			
Xiaoxiao Li	-	-	-	-	-	-			
<b>Former Directors</b>									
Joseph Belan	100,000	-	-	-	(100,000)	-	August 26, 2016	June 30, 2017 - June 30, 2018	0.25
	75,000	-	-	-	(75,000)	-	November 16, 2016	June 30, 2017 - June 30, 2018	0.33
	75,000	-	-	-	(75,000)	-	November 16, 2016	June 30, 2017 - June 30, 2018	0.33
	<b>250,000</b>	-	-	-	<b>(250,000)</b>	-			
Ningqiao Li	<b>100,000</b>	-	-	-	<b>(100,000)</b>	-	December 14, 2015	December 14, 2016 - June 30, 2018	0.29
Zhu Liu	100,000	-	-	-	-	100,000	December 14, 2015	December 14, 2016 - June 28, 2019	0.29
	75,000	-	-	-	-	75,000	November 16, 2016	November 16, 2017 - June 28, 2019	0.33
	75,000	-	-	-	-	75,000	November 16, 2016	November 16, 2018 - June 28, 2019	0.33
	150,000	-	-	-	-	150,000	June 30, 2017	June 30, 2018 - June 28, 2019	0.33
	<b>400,000</b>	-	-	-	-	<b>400,000</b>			
Aminbuhe	<b>100,000</b>	-	-	-	-	<b>100,000</b>	December 14, 2015	December 14, 2016 - June 28, 2019	0.29
Yulan Guo	<b>100,000</b>	-	-	-	-	<b>100,000</b>	December 14, 2015	December 14, 2016 - June 28, 2019	0.29
<b>Total for directors</b>	<b>2,100,000</b>	-	-	-	<b>(350,000)</b>	<b>1,750,000</b>			
<b>Other share option holders</b>									
	8,885	-	-	-	-	8,885	March 26, 2014	March 26, 2015 - March 26, 2019	0.65
	24,134	-	-	-	-	24,134	August 13, 2014	August 13, 2015 - March 13, 2016	0.58
	157,443	-	-	-	-	157,443	April 1, 2015	April 1, 2016 - April 1, 2020	0.92
<b>Total for other share option holders</b>	<b>190,462</b>	-	-	-	-	<b>190,462</b>			
<b>Total</b>	<b>2,290,462</b>	-	-	-	<b>(350,000)</b>	<b>1,940,462</b>			