SouthGobi Resources announces third quarter 2017 financial and operating results

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VANCOUVER, British Columbia, Nov. 14, 2017 (GLOBE NEWSWIRE) -- SouthGobi Resources Ltd. (TSX:SGQ) (HK:1878) (the "Company" or “SouthGobi”) today announces its financial and operating results for the three and nine months ended September 30, 2017. All figures are in U.S. dollars (“USD”) unless otherwise stated.

Significant Events and Highlights

The Company’s significant events and highlights for the three months ended September 30, 2017 and subsequent period up to November 13, 2017 are as follows:

- *Operating Results* – As a result of improved market conditions and prices for coal in the People’s Republic of China (“China”), the Company experienced an increase in the average selling price of coal from $15.79 per tonne for the third quarter of 2016 to $26.47 per tonne for the third quarter of 2017. However, as a result of delays in the custom clearance process at the Ceke border which the Company has been experiencing since July 2017, the volume of coal sales has dropped from 1.13 million tonnes for the third quarter of 2016 to 0.80 million tonnes for the third quarter of 2017. As of the date of this announcement, the situation has improved slightly and the Company continues to closely monitor the situation at the Ceke border.
- *Financial Results* – The Company recorded a gross loss of $5.7 million during the quarter compared to a gross loss of $5.6 million in the third quarter of 2016. Revenue was $19.4 million in the third quarter of 2017 as compared to $16.4 million in the third quarter of 2016. The financial results of the third quarter of 2017 are comparable to the comparative 2016 quarter as a result of increased coal price due to improved market conditions in China offset by decreased sales volume caused by delays in the custom clearance process at the Ceke border experienced during the quarter.
- *CIC Investment Corporation (“CIC”) Convertible Debenture (“CIC Convertible Debenture”)* – Pursuant to the terms of the deferral agreement dated June 12, 2017 (the “June 2017 Deferral Agreement”) with CIC in relation to a revised payment schedule on the $22.3 million of cash interest and associated costs originally due under the CIC Convertible Debenture on May 19, 2017, the Company is required to pay $9.7 million of cash interest and associated costs to CIC on November 19, 2017 (the “June 2017 Deferral Agreement Payment”). In addition, pursuant to the terms of the CIC Convertible Debenture, the Company is required pay $8.1 million of anniversary cash interest to CIC on November 19, 2017 (the “November Interest Payment” and together with the June 2017 Deferral Agreement Payment, the “November 19th Payments”). As of the date hereof, the Company expects that it will be unable to pay the November 19th Payments to CIC on the due date. The Company is currently in discussions with CIC for a further deferral of the November 19th Payments; however, there can be no assurance that a favorable outcome will be reached. If a further deferral of the November 19th Payments cannot be agreed to with CIC by November 19, 2017, then 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.
- *Equipment Loan –* Inner Mongolia SouthGobi Energy Ltd., a subsidiary of the Company executed a $10 million loan agreement on August 31, 2017 with Beijing Jin Rui Tian Chen Asset Management Co Ltd. (the “Equipment Loan”) for the purpose of financing the purchase of mining equipment to increase the production capacity of the Company.

- *Class Action Lawsuit* – On September 18, 2017, the Ontario Court of Appeal dismissed the Company’s appeal of the original Ontario lower court decision to permit the plaintiff to commence and proceed with a class action (the “Class Action”) against the Company claiming damages under the Ontario Securities Act in connection with the Company’s restatement of certain financial statements previously disclosed in the Company’s public fillings (the “Restatement”). Concurrently, the Ontario Court of Appeal allowed the plaintiff’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 of the Company. The Company intends to seek leave to appeal to the Supreme Court of Canada.
- *Ceke Logistics Park Project* – On October 10, 2017, the Company entered into an investment agreement (“Investment Agreement”) with Beijing De Rong Tai Investment Co., Ltd. (“BDRT”) in connection with the Company’s development of the Ceke Port Eco-friendly Bonded Logistics Park project (the “Ceke Logistics Park”). Pursuant to the Investment Agreement, BDRT has agreed, subject to fulfilment of certain conditions, to invest RMB231 million in instalments by July 30, 2018 in return for a 30% interest in Inner Mongolia SouthGobi Enterprise Co. Ltd. (“IMSE”), while the Company will hold the remaining 70% interest in IMSE. Proceeds from BDRT’s equity investment will be used by IMSE for the construction of the Ceke Logistics Park. IMSE is the project company which holds a 100% interest in the Ceke Logistics Park.
- *Changes in Management and Director*

Mr. Huiyi Wang: Mr. Wang resigned as a non-executive director on July 24, 2017.

Mr. Aminbuhe: Mr. Aminbuhe commenced a leave from his role as Chief Executive Officer of the Company, effective as of November 13, 2017.

Mr. Bing Wang: Mr. Wang was appointed as interim Chief Executive Officer of the Company, effective as of November 13, 2017.

- *Going Concern –* As at the date hereof, the Company has initiated a plan to change the existing product mix to higher value and higher margin outputs by washing certain grades of coal commencing in the fourth quarter of 2017 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 Company has also completed a new mine plan, which 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 involve the need for a significant level of stripping activities over the next two years and require certain capital expenditures to achieve the designed production outputs. Such expenditures will require the Company to seek additional financing in the form of finance leases, debt or equity. The Company has entered into an agreement for a finance lease on the new wash plant facility but will need additional financing to complete the thermal coal processing facilities.

There is no guarantee that the Company will be able to successfully secure additional sources of financing. This could result in adjustments to the amounts and classifications of assets and liabilities in the Company’s condensed 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. See section “Liquidity and Capital Resources” for details. As at November 13, 2017, the Company had $1.9 million of cash.

OVERVIEW OF OPERATIONAL DATA AND FINANCIAL RESULTS

Summary of Operational Data

	Three months ended September 30,	Nine months ended September 30,

	2017	2016	2017	2016
Sales Volumes, Prices and Costs				
Premium semi-soft coking coal				
Coal sales *(millions of tonnes)*	0.12	0.07	0.49	0.13
Average realized selling price *(per tonne)* *(i)*	$ 46.81	$ 21.04	$ 45.93	$ 21.19
Standard semi-soft coking coal				
Coal sales *(millions of tonnes)*	0.41	0.77	1.84	1.87
Average realized selling price *(per tonne)* *(i)*	$ 28.32	$ 15.66	$ 25.89	$ 16.69
Thermal coal				
Coal sales *(millions of tonnes)*	0.27	0.29	1.06	0.83
Average realized selling price *(per tonne)* *(i)*	$ 14.54	$ 14.79	$ 14.77	$ 11.11
Total				
Coal sales *(millions of tonnes)*	0.80	1.13	3.39	2.83
Average realized selling price *(per tonne)* *(i)*	$ 26.47	$ 15.79	$ 25.29	$ 15.27
Raw coal production *(millions of tonnes)*	2.47	1.13	5.87	2.17
Cost of sales of product sold *(per tonne)*	$ 31.31	$ 19.53	$ 22.48	$ 22.65
Direct cash costs of product sold *(per tonne)* *(ii)*	$ 10.98	$ 7.13	$ 9.10	$ 8.92
Mine administration cash costs of product sold *(per tonne)* *(ii)*	$ 2.98	$ 2.26	$ 2.00	$ 1.96
Total cash costs of product sold *(per tonne)* *(ii)*	$ 13.96	$ 9.39	$ 11.10	$ 10.88
Other Operational Data				
Production waste material moved *(millions of bank cubic meters)*	6.77	2.22	16.43	4.76
Strip ratio *(bank cubic meters of waste material per tonne of coal produced)*	2.74	1.96	2.80	2.19
Lost time injury frequency rate *(iii)*	0.04	0.00	0.03	0.00

(i) Average realized selling price is presented before deduction of royalties and selling fees.
(ii) A Non-International Financial Reporting Standards (“IFRS”) financial measure, see “Non-IFRS Financial Measures” section. Cash costs of product sold exclude idled mine asset cash costs.
(iii) Per 200,000 man hours and calculated based on a rolling 12 month average.

Overview of Operational Data

For the third quarter of 2017, the Company had a lost time injury frequency rate of 0.04 per 200,000 man hours based on a rolling 12 month average.

For the three months ended September 30, 2017

As a result of improved market conditions and prices for coal in China, the Company experienced an increase in the average selling price of coal as compared to the third quarter of 2016. However the Company has been experiencing delays in the custom clearance process at the Ceke border since July 2017, and these delays have caused the typical turnaround time for the coal exporting trucks which transport coal from the Company’s mine site to the Ceke border to take at least twice as long as normal. As a result, the volume of coal sales has dropped as compared to the third quarter of 2016. The Company continues to closely monitor the situation at the Ceke border.

The Company sold 0.8 million tonnes of coal product during the third quarter of 2017 as compared to 1.13 million tonnes for the third quarter of 2016. The average realized selling price increased from $15.79 per tonne for the third quarter of 2016 to $26.47 per tonne for the third quarter of 2017, which was mainly a result of improved market conditions as well as improved product mix. The product mix for the third quarter of 2017 consisted of approximately 15% of premium semi-soft coking coal, 51% of standard semi-soft coking coal and 34% of thermal coal compared to approximately 7% of premium semi-soft coking coal, 68% of standard semi-soft coking coal and 25% of thermal coal for the third quarter of 2016.

The Company also improved the pacing of production to meet the anticipated demand, such that production was 2.47 million tonnes for the third quarter of 2017 as compared to 1.13 million tonnes for the third quarter of 2016.

The Company’s unit cost of sales of product sold increased to $31.31 per tonne in the third quarter of 2017 from $19.53 per tonne in the third quarter of 2016. The increase was mainly driven by the coal stockpile impairments of $7.9 million during the quarter as compared to $1.5 million for the third quarter of 2016.

For the nine months ended September 30, 2017

Despite the delay in the custom clearance process at the Ceke border as mentioned above, the overall market conditions and prices for coal generally have improved in China in 2017. The Company experienced an increase in the tonnage of coal product sold from 2.83 million tonnes during the first nine months of 2016 to 3.39 million tonnes for the first nine months of 2017. The average selling price also increased from $15.27 per tonne for the first nine months of 2016 to $25.29 per tonne for the first nine months of 2017, which was mainly due to the improved market conditions.

Production in the first nine months of 2017 was higher than the first nine months of 2016, increasing from 2.17 million tonnes to 5.87 million tonnes, as a result of pacing production with the current and expected demand.

The Company’s unit cost of sales of product sold maintained at similar level for the first nine months of 2017 of $22.48 as compared to $22.65 for the first nine months of 2016.

Summary of Financial Results

	Three months ended September 30,		Nine months ended September 30,	
$ in thousands, except per share information	2017	2016	2017	2016
Revenue [(i),(ii)]	$ 19,356	$ 16,379	$ 79,275	$ 39,467
Cost of sales [(ii)]	(25,049)	(22,018)	(76,193)	(64,203)
Gross profit/(loss) excluding idled mine asset costs	(3,528)	(3,162)	10,631	(14,137)
Gross profit/(loss) including idled mine asset costs	(5,693)	(5,639)	3,082	(24,736)
Other operating income/(expenses)	3,477	4,631	(3,776)	3,732
Administration expenses	(2,451)	(2,042)	(7,070)	(5,510)
Evaluation and exploration expenses	(48)	(101)	(221)	(200)
Loss from operations	(4,715)	(3,151)	(7,985)	(26,714)
			-	-
Finance costs	(5,674)	(6,358)	(16,708)	(16,910)
Finance income	142	5	21	8
Share of earnings of a joint venture	265	89	919	428
Income tax expense	238	82	(2,521)	(176)
			-	-
Net loss	(9,744)	(9,333)	(26,274)	(43,364)
Basic and diluted loss per share	$ (0.04)	$ (0.04)	$ (0.10)	$ (0.17)

(i) Revenue is presented after the deduction of royalties and selling fees.
(ii) Revenue and cost of sales relate to the Company’s Ovoot Tolgoi Mine within the Coal Division operating segment. Refer to note 3 of the condensed consolidated interim financial statements for further analysis regarding the Company’s reportable operating segments.

Overview of Financial Results

For the three months ended September 30, 2017

The Company recorded a gross loss of $5.7 million during the quarter compared to a gross loss of $5.6 million in the third quarter of 2016. The Company recorded a $4.7 million loss from operations during the quarter compared to a $3.2 million loss from operations in the third quarter of 2016. The operations for the three months ended September 30, 2017 were impacted by delays experienced by the Company in the custom clearance process at the Ceke border as mentioned above.

The Company earned revenue of $19.4 million in the third quarter of 2017 compared to $16.4 million in the third quarter of 2016.

The Company’s revenue is presented after deduction of royalties and selling fees. The Company’s effective royalty rate for the third quarter of 2017, based on the Company’s average realized selling price of $26.47 per tonne, was 6.1% or $1.63 per tonne compared to 6.9% or $1.08 per tonne based on the average realized selling price of $15.79 per tonne in the third quarter of 2016.

Royalty regime in Mongolia

The royalty regime in Mongolia is evolving and has been subject to change since 2012.

On February 1, 2016, the Government of Mongolia issued a resolution in connection with the royalty regime. From February 1, 2016 onwards, royalties are to be calculated based on the actual contract price in which transportation cost to the Mongolia border should have been included. If such transportation cost was not included in the contract, the relevant transportation costs, custom documentation fees, insurance and loading costs should be estimated for the calculation of royalties. In the event that the calculated sales price as described above differs from the contract sales price of other entities in Mongolia (same quality of coal and same border crossing) by more than 10%, the calculated sales price will be deemed to be “non-market” under Mongolian tax law and the royalty will then be calculated based on a reference price as determined by the Government of Mongolia.

Cost of sales was $25.0 million in the third quarter of 2017 compared to $22.0 million in the third quarter of 2016, the increase was mainly due to the impairment of coal stockpile inventories of $7.9 million that was recorded this quarter (2016: $1.5 million). Cost of sales comprises operating expenses, share-based compensation expense, equipment depreciation, depletion of mineral properties, coal stockpile inventory impairments and idled mine asset costs. Operating expenses in cost of sales reflect the total cash costs of product sold (a non-IFRS financial measure, see section “Non-IFRS Financial Measures” for further analysis) during the period.

	Three months ended September 30,	
$ in thousands	2017	2016
Operating expenses	$ 11,165	$ 10,823
Share-based compensation expense	2	2
Depreciation and depletion	2,350	7,183
Impairment of coal stockpile inventories	7,933	1,533
Cost of sales from mine operations	21,450	19,541
Cost of sales related to idled mine assets	3,599	2,477
Cost of sales	$ 25,049	$ 22,018

Cost of sales in the third quarter of 2017 and 2016 included coal stockpile impairments of $7.9 million and $1.5 million, respectively, to reduce the carrying value of the Company’s coal stockpiles to their net realizable value. The coal stockpile impairments recorded in both the third quarter of 2017 and 2016 primarily related to the Company’s higher-ash products.

Cost of sales related to idled mine asset costs primarily consisted of period costs, which were expensed as incurred and included mainly depreciation expense. Cost of sales related to idled mine assets in the third quarter of 2017 included $3.6 million of depreciation expenses for idled equipment compared to $2.5 million in the third quarter of 2016.

Other operating income was $3.5 million in the third quarter of 2017 compared to $4.6 million in the third quarter of 2016 as follows:

	Three months ended September 30,	
$ in thousands	2017	2016
Foreign exchange gain	$ 2,128	$ 4,655
Reversal of provision for doubtful trade and other receivables	1,389	-
Other	(40)	(24)
Other operating income	$ 3,477	$ 4,631

A foreign exchange gain of $2.1 million (2016: $4.7 million) was recorded as a result of the significant appreciation of RMB against the U.S. dollar during the quarter. The key underlying driver of the foreign exchange gain is that some trade receivables which are denominated in RMB.

The Company reversed a provision for doubtful trade and other receivables of $1.4 million as a result of collecting certain long aged receivables during the third quarter of 2017.

Administration expenses were $2.5 million in the third quarter of 2017 compared to $2.0 million in the third quarter of 2016 as follows:

	Three months ended September 30,	
$ in thousands	2017	2016
Corporate administration	$ 919	$ 877
Professional fees	508	400
Salaries and benefits	952	713
Share-based compensation expense	32	28
Depreciation	40	24
Administration expenses	$ 2,451	$ 2,042

The increase in salaries and benefits was mainly due to the operations of the new subsidiaries in China, which was incorporated to expand the sales channels of coal in China.

Evaluation and exploration expenses were $0.1 million in the third quarter of 2017 (2016: $0.1 million). The Company continued to minimize evaluation and exploration expenditures in the third quarter of 2017 in order to preserve the Company’s financial resources.

Finance costs were $5.7 million and $6.4 million respectively in the third quarter of 2017 and the third quarter of 2016. Finance costs primarily consisted of interest expense in respect of the $250.0 million CIC Convertible Debenture ($5.4 million for both the third quarter of 2017 and the third quarter of 2016).

For the nine months ended September 30, 2017

The Company recorded an $8.0 million loss from operations in the first nine months of 2017 compared to a

$26.7 million loss from operations in the first nine months of 2016. The operations for the nine months ended September 30, 2017 were positively impacted by improved market conditions resulting in higher sales volumes as well as the improved coal prices in China.

Revenue was $79.3 million in the first nine months of 2017 compared to $39.5 million in the first nine months of 2016. The Company sold 3.39 million tonnes of coal at an average realized selling price of $25.29 per tonne in the first nine months of 2017 compared to sales of 2.83 million tonnes at an average realized selling price of $15.27 per tonne in the first nine months of 2016, which was mainly a result of improved market conditions.

The Company’s revenue is presented net of royalties and selling fees. The Company’s effective royalty rate for the first nine months of 2017, based on the Company’s average realized selling price of $25.29 per tonne, was 5.8% or $1.46 per tonne compared to 7.0% or $1.06 per tonne based on the average realized selling price of $15.27 per tonne in the first nine months of 2016.

Cost of sales was $76.2 million in the first nine months of 2017 compared to $64.2 million in the first nine months of 2016 as follows:

	Nine months ended September 30,	
$ in thousands	2017	2016
Operating expenses	$ 36,756	$ 29,356
Share-based compensation expense/(recovery)	30	(6)
Depreciation and depletion	17,290	17,015
Impairment of coal stockpile inventories	13,134	7,239
Cost of sales from mine operations	67,210	53,604
Cost of sales related to idled mine assets	8,983	10,599
Cost of sales	$ 76,193	$ 64,203

Operating expenses in cost of sales were $36.8 million in the first nine months of 2017 compared to $29.4 million in the first nine months of 2016. The increase in operating expenses was primarily related to the increase in sales volume from 2.83 million tonnes in the first nine months of 2016 to 3.39 million tonnes in the first nine months of 2017.

Cost of sales in the first nine months of 2017 and the first nine months of 2016 included coal stockpile impairments of $13.1 million and $7.2 million, respectively, to reduce the carrying value of the Company’s coal stockpiles to their net realizable value. The coal stockpile impairments recorded in both 2017 and 2016 primarily related to the Company’s higher-ash products.

Cost of sales related to idled mine asset costs primarily consisted of period costs, which were expensed as incurred and primarily included depreciation expense. Cost of sales related to idled mine assets in the first nine months of 2017 included $9.0 million related to depreciation expenses for idled equipment (2016: $10.6 million).

Other operating expenses were $3.8 million in the first nine months of 2017 compared to other operating income of $3.7 million in the first nine months of 2016 as follows:

	Nine months ended September 30,	
$ in thousands	2017	2016
Foreign exchange gain	$ 23	$ 3,141
Impairment of properties held for sale	(1,075)	-
Mining services, net	(2,395)	-
Reversal of provision/(provision) for doubtful trade and other receivables	54	(2)

Penalty on late settlement of trade payables	(280)	-
Discount on settlement of trade payables	-	1,009
Other	(103)	(416)
Other operating income/(expenses)	$ (3,776)	$ 3,732

Mining services at the Tavan Tolgoi deposit were provided by the Company to Erdenes Tavan Tolgoi JSC (“Erdenes”) in connection with settlement of the Tax Penalty (as defined below) at a net cost of $2.4 million in the first nine months of 2017 (direct mining costs and depreciation totaling $8.0 million, net of service revenue of $5.6 million) (see “*Regulatory Issues and Contingencies – Governmental and Regulatory Investigations*” for more details).

Administration expenses were $7.1 million in the first nine months of 2017 compared to $5.5 million in the first nine months of 2016 as follows:

	Nine months ended September 30,	
$ in thousands	2017	2016
Corporate administration	$ 1,955	$ 2,035
Professional fees	1,959	1,295
Salaries and benefits	2,835	2,033
Share-based compensation expense	67	33
Depreciation	254	114
Administration expenses	$ 7,070	$ 5,510

The increase in salaries and benefits was mainly due to the operations of the new subsidiaries in China, which was incorporated to expand the sales channels of coal in China.

Evaluation and exploration expenses were $0.2 million in the first nine months of 2017 (2016: $0.2 million). The Company continued to minimize evaluation and exploration expenditures in the first nine months of 2017 in order to preserve the Company’s financial resources. Evaluation and exploration activities and expenditures in the first nine months of 2017 were limited to ensuring that the Company met the Mongolian Minerals Law requirements in respect of its mining and exploration licenses.

Finance costs were $16.7 million and $16.9 million in the first nine months of 2017 and 2016 respectively. This primarily consisted of interest expense on the CIC Convertible Debenture ($16.0 million for the first nine months of 2017 and $15.9 million for the first nine months of 2016).

Summary of Quarterly Operational Data

	2017			2016			
Quarter Ended	30-Sep	30-Jun	31-Mar	31-Dec	30-Sep	30-Jun	31
Sales Volumes, Prices and Costs							
Premium semi-soft coking coal							
Coal sales *(millions of tonnes)*	0.12	0.18	0.19	0.15	0.07	-	0
Average realized selling price *(per tonne)* (i)	$ 46.81	$ 45.67	$ 45.61	$ 40.49	$ 21.04	$ -	$ 2
Standard semi-soft coking coal							
Coal sales *(millions of tonnes)*	0.41	0.79	0.64	0.65	0.77	0.52	0
Average realized selling price *(per tonne)* (i)	$ 28.32	$ 26.69	$ 23.36	$ 16.79	$ 15.66	$ 16.27	$ 1
Thermal coal							
Coal sales *(millions of tonnes)*	0.27	0.51	0.28	0.28	0.29	0.30	0
Average realized selling price *(per tonne)* (i)	$ 14.54	$ 15.79	$ 13.17	$ 15.26	$ 14.79	$ 9.17	$ 9

Total							
Coal sales *(millions of tonnes)*	0.80	1.48	1.11	1.08	1.13	0.82	0
Average realized selling price *(per tonne)* (i)	$ 26.47	$ 25.24	$ 24.52	$ 19.55	$ 15.79	$ 13.65	$ 1
Raw coal production *(millions of tonnes)*	2.47	1.89	1.51	1.21	1.13	0.67	0
Cost of sales of product sold *(per tonne)*	$ 31.31	$ 18.50	$ 21.40	$ 21.15	$ 19.53	$ 28.01	$ 2
Direct cash costs of product sold *(per tonne)* (ii)	$ 10.98	$ 7.84	$ 9.42	$ 7.97	$ 7.13	$ 12.47	$ 7
Mine administration cash costs of product sold *(per tonne)* (ii)	$ 2.98	$ 2.22	$ 1.01	$ 3.23	$ 2.26	$ 2.32	$ 1
Total cash costs of product sold (*per tonne)* (ii)	$ 13.96	$ 10.06	$ 10.43	$ 11.20	$ 9.39	$ 14.79	$ 9
Other Operational Data							
Production waste material moved *(millions of bank cubic meters)*	6.77	6.36	3.30	2.62	2.22	1.82	0
Strip ratio *(bank cubic meters of waste material per tonne of coal produced)*	2.74	3.37	2.18	2.16	1.96	2.71	1
Lost time injury frequency rate (iii)	0.04	0.04	0.02	0.00	0.00	0.00	0

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

Summary of Quarterly Financial Results

The Company’s financial statements are reported under IFRS issued by the International Accounting Standards Board (“IASB”). The following tables provide highlights, extracted from the Company’s annual and interim financial statements, of quarterly results for the past eight quarters:

$ in thousands, except per share information	2017			2016		
Quarter Ended	30-Sep	30-Jun	31-Mar	31-Dec	30-Sep	30-Jun
Financial Results						
Revenue (i), (ii)	$ 19,356	$ 34,665	$ 25,254	$ 18,983	$ 16,379	$ 10,36
Cost of sales (ii)	(25,049)	(27,385)	(23,759)	(22,842)	(22,018)	(23,1
Gross profit/(loss) excluding idled mine asset costs	(3,528)	9,445	4,714	(2,353)	(3,162)	(9,92
Gross profit/(loss) including idled mine asset costs	(5,693)	7,280	1,495	(3,859)	(5,639)	(12,7
Other operating income/(expenses)	3,477	(4,045)	(3,208)	(3,782)	4,631	812
Administration expenses	(2,451)	(2,234)	(2,385)	(2,378)	(2,042)	(1,82
Evaluation and exploration expenses	(48)	(144)	(29)	(222)	(101)	(52
Impairment of property, plant and equipment	-	-	-	(1,152)	-	-
Profit/(loss) from operations	(4,715)	857	(4,127)	(11,393)	(3,151)	(13,8
Finance costs	(5,674)	(5,494)	(5,715)	(5,645)	(6,358)	(5,37
Finance income	142	50	4	472	5	324
Share of earnings/(losses) of a joint venture	265	388	266	378	89	256
Income tax credit/(expense)	238	(2,714)	(45)	(1,294)	82	(23
Net loss	(9,744)	(6,913)	(9,617)	(17,482)	(9,333)	(18,6
Basic and diluted loss per share	$ (0.04)	$ (0.03)	$ (0.04)	$ (0.07)	$ (0.04)	$ (0.07

(i) Revenue is presented after the deduction of royalties and selling fees.
(ii) Revenue and cost of sales relate to the Company’s Ovoot Tolgoi Mine within the Coal Division operating segment. Refer to note 3 of the condensed consolidated interim financial statements for further

analysis regarding the Company’s reportable operating segments.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity and Capital Management

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

Turquoise Hill Resources Ltd. (“Turquoise Hill”) Loan Facility (the “TRQ Loan”)

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 loan from Turquoise Hill in the form of a $10 million revolving credit facility to meet its short term working capital requirements (the “TRQ Loan”) to December 29, 2017 in accordance with the schedule of repayments set out below:

- The Company has agreed to effect monthly repayments on the last business day of each month in an amount of (i) $0.15 million per month starting on May 31, 2016 and ending on April 28, 2017; (ii) $0.2 million per month starting on May 31, 2017 and ending on December 29, 2017; and (iii) the remaining balance on December 29, 2017 (collectively (i) to (iii), the Repayments, and each, a Repayment). Upon receipt of each Repayment by Turquoise Hill, the aggregate amount of obligations owing under the TRQ Loan will be reduced by such equal amount;
- In the event that the Company fails to make any one of the Repayments in its entirety on or before the dates set out above, then the Company shall be in automatic and irremediable default of the obligations thereunder and under the TRQ Loan, shall immediately and irremediably lose all benefits of the May 2016 Deferral Agreement, and all then outstanding obligations shall become immediately due and payable to Turquoise Hill; and
- Interest shall continue to accrue on all outstanding obligations at the 12-month US dollar LIBOR rate.

Unless otherwise agreed by Turquoise Hill, under certain circumstances, including the non-payment of interest amounts as the same become due, amounts outstanding under the TRQ Loan 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 TRQ Loan. Subject to notice and cure periods, certain events of default under the TRQ Loan will result in acceleration of the indebtedness under such loan at the option of Turquoise Hill.

At September 30, 2017, the outstanding principal and accrued interest under this facility amounted to $1.2 million and $0.7 million, respectively (at December 31, 2016, the outstanding principal and accrued interest under the facility amounted to $2.2 million and $0.7 million, respectively).

The Company was late in repaying its July 2017 monthly payment under the May 2016 Deferral Agreement. As of the date of this announcement, the Company has not paid its August, September and October 2017 monthly payments.

Equipment loan

Inner Mongolia SouthGobi Energy Ltd., a subsidiary of the Company executed a $10 million loan agreement on August 31, 2017 with Beijing Jin Rui Tian Chen Asset Management Co Ltd. 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 million;
- Maturity date set at 12 months from each drawdown;
- Interest rate of 12% per annum and payable upon maturity; and

- The Company provided a corporate guarantee to cover the principal and interest owed and certain items of property, plant and equipment will be pledged as security upon the completion of equipment purchase.

As at September 30, 2017, the outstanding balance for the bank loan was $2.1 million (December 31, 2016: nil).

A loan arrangement fee of 1% of the loan principal drawn was charged and will be amortized throughout the loan term.

Bank loan

On May 6, 2016, SouthGobi Sands LLC (“SGS”), a subsidiary of the Company, obtained a bank loan (the “Bank Loan”) in the principal amount of $2.0 million 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 $3.0 million;
- $2.3 million of the principal amount will mature on May 6, 2018, while the remaining balance of the principal amount of $0.7 million will mature on January 4, 2019;
- Interest rate of 15.8% per annum applies to the $2.3 million portion of the principal amount, while an interest rate of 15.0% per annum applies to the remaining $0.7 million portion of the principal amount; in each case, interest is payable monthly; and
- Certain items of property, plant and equipment with value of $5.4 million as at September 30, 2017 were pledged as security.

As at September 30, 2017, the outstanding balance for the Bank Loan was $3.0 million (December 31, 2016: $2.0 million) and the Company owed accrued interest of $0.1 million (December 31, 2016: $0.1 million).

Costs reimbursable to Turquoise Hill

Prior to the completion of the private placement with Novel Sunrise Investments Limited (“Novel Sunrise”) on April 23, 2015, Rio Tinto Plc (“Rio Tinto”) was the Company’s ultimate parent company. In the past, Rio Tinto has sought reimbursement from the Company for the salaries and benefits of certain Rio Tinto employees who were assigned by Rio Tinto to work for the Company, as well as certain legal and professional fees incurred by Rio Tinto in relation to the Company’s prior internal investigation and Rio Tinto’s participation in the tripartite committee. Subsequently Rio Tinto transferred and assigned to Turquoise Hill its right to seek reimbursement for these costs and fees from the Company.

As at September 30, 2017, the amount of reimbursable costs and fees claimed by Turquoise Hill (the “TRQ Reimbursable Amount”) amounted to $8.0 million (such amount is included in the aging profile of trade and other payables set out below). On October 12, 2016, the Company received a letter from Turquoise Hill, which proposed an arrangement for regular payments of the outstanding TRQ Reimbursable Amount. The Company is currently in negotiations with Turquoise Hill regarding the proper quantum of the TRQ Reimbursable Amount and the terms for repayment. There can be no assurance, however, that any such terms can be successfully negotiated by the Company either at all or on favorable terms.

Going concern considerations

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 September 30, 2018 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 $59.7 million as at September 30, 2017 compared to $59.4 million of working capital deficiency as at December 31, 2016. Included in the working capital deficiency as at September 30, 2017 are significant obligations, which come due in the short-term, including the agreement to pay $12.0 million to CIC from October to November 2017, pursuant to the June 2017 Deferral Agreement and payment of the November Interest Payment to CIC pursuant to the Convertible Debenture. Although the Company has been in discussion with CIC for a further deferral of the aforementioned payments, there can be no assurance that a favorable outcome can be reached.

Further, the trade and other payables of the Company have continued to accumulate due to liquidity constraints. The aging profile of trade and other payables has worsened as compared to December 31, 2016, as follows:

$ in thousands	As at September 30, 2017	December 31, 2016
Less than 1 month	$ 27,326	$ 14,640
1 to 3 months	9,245	2,493
3 to 6 months	8,727	2,648
Over 6 months	29,658	23,847
Total trade and other payables	$ 74,956	$ 43,628

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 November 13, 2017.

The Company also has other current liabilities, which require settlement in the short-term, including: the remaining cash payments of $2.0 million due in connection with the Tax Penalty owing to the Government of Mongolia; the ICIC LLC (“ICIC”) settlement in the amount of $2.3 million due between October and November 2017 pursuant to the Triparty Settlement Agreement; the $1.9 million balance of the TRQ Loan payable in monthly payments with the balance due in December 2017; the Equipment Loan of $2.1 million due in July 2018 and the Bank Loan of $3.0 million due in May 2018.

The Company is also party to a commercial arbitration in Hong Kong with First Concept Logistic Limited (“First Concept”), involving an $11.5 million amount received by the Company as a coal supply contract prepayment, whereby First Concept is seeking to recover its deposit rather than completing the contracted coal purchases. Should the Company be unsuccessful in arbitration, the Company may be compelled to repay the $11.5 million deposit sought by First Concept, which would negatively impact the liquidity of the Company.

The Company has initiated a plan to change the existing product mix to higher value and higher margin outputs by washing certain grades of coal commencing in the fourth quarter of 2017 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 Company has also completed a new mine plan, which 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 involve the need for a significant level of stripping activities over the next two years and require 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. The Company has entered into an agreement for a finance lease on the new wash plant facility but will need financing to complete the thermal coal processing facilities.

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 September 30, 2018, 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 condensed 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.

Continuing delay in securing additional financing could ultimately result in an event of default of the CIC Convertible Debenture, the TRQ Loan, the Equipment Loan and the Bank Loan, which if not cured within applicable cure periods in accordance with the terms of respective instruments, may result in the principal amounts owing and all accrued and unpaid interest becoming immediately due and payable upon notice to the Company by CIC, Turquoise Hill, the lender of the Equipment Loan and the lender of the Bank Loan, respectively.

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 September 30, 2017, the Company’s gearing ratio was 0.38 (December 31, 2016: 0.37), which was calculated based on the Company’s long term liabilities to total assets. As at September 30, 2017 and December 31, 2016, the Company was not subject to any externally imposed capital requirements.

As at November 13, 2017, the Company had $1.9 million of cash.

CIC Convertible Debenture

In November 2009, the Company entered into a financing agreement with a wholly owned subsidiary of CIC for $500 million in the form of a secured, convertible debenture bearing interest at 8.0% (6.4% payable semi-annually in cash and 1.6% payable annually in the Company’s shares) with a maximum term of 30 years. The CIC Convertible Debenture is secured by a first ranking charge over the Company’s assets and certain subsidiaries. The financing was used primarily to support the accelerated investment program in Mongolia and for working capital, repayment of debt, general and administrative expenses and other general corporate purposes.

On March 29, 2010, the Company exercised its right to call for the conversion of up to $250.0 million of the CIC Convertible Debenture into approximately 21.5 million shares at a conversion price of $11.64 (CAD$11.88). As at September 30, 2017, CIC owned, through its indirect wholly-owned subsidiary, approximately 23.8% of the issued and outstanding common shares of the Company.

On June 12, 2017, the Company executed the June 2017 Deferral Agreement with CIC for a revised repayment schedule on the May 2017 Interest Payable. The key repayment terms of the June 2017 Deferral Agreement are: (i) the Company is required to repay on average $2.2 million of the cash interest and associated costs monthly during the period from May 2017 to October 2017; and (ii) the Company is required to repay $9.7 million 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.

To date, the Company has made all payments due under the June 2017 Deferral Agreement.

Pursuant to the terms of the June 2017 Deferral Agreement, the Company is required to pay $9.7 million of cash interest and associated costs to CIC on November 19, 2017. In addition, pursuant to the terms of the CIC Convertible Debenture, the Company is required pay $8.1 million of anniversary cash interest to CIC on November 19, 2017. As of the date hereof, the Company expects that it will be unable to pay the November 19th Payments to CIC on the due date. The Company is currently in discussions with CIC for a further deferral of the November 19th Payments; however, there can be no assurance that a favorable outcome will be reached. If a further deferral of the November 19th Payments cannot be agreed to with CIC by November 19, 2017, then 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.

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.

Ovoot Tolgoi Mine Impairment Analysis

The Company determined that an indicator of impairment existed for its Ovoot Tolgoi Mine cash generating unit as at September 30, 2017. 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” 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 and washing assumptions, operating cost and life of mine coal production assumptions as at September 30, 2017. The Company’s Ovoot Tolgoi Mine cash generating unit carrying value was $117.0 million as at September 30, 2017.

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;
- Updated life-of-mine coal production, strip ratio, capital costs and operating costs;
- Coal washing to increase the volume of premium semi-soft coking coal sold;
- Coal processing to increase the grade and qualities of the thermal coal produced and sold; and
- A post-tax discount rate of 16.1% 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 September 30, 2017. 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.

REGULATORY ISSUES AND CONTINGENCIES

Governmental and Regulatory Investigations

In May 2016, the Resolution 258 of the Government of Mongolia was issued, which approved the

Company’s proposal to partially settle a prior written verdict of the Mongolian Second District Criminal Court which declared SGS to be financially liable as a “civil defendant” for a penalty (the “Tax Penalty”) of MNT 35.3 billion (approximately $18.2 million on February 1, 2015) by way of certain cash payments in 2016 and 2017 and by the Company performing certain mining operations at the Tavan Tolgoi deposit on behalf of Erdenes. Subsequent to this Resolution, the Company made cash payments of $2.4 million during 2016 as a partial settlement of the Tax Penalty.

In compliance with the Resolution 258, in November 2016, the Company entered into an agreement with Erdenes under which the Company agreed to perform certain mining operations equivalent to MNT 20.3 billion (approximately $8.1 million) in the West Tsankhi section of the Tavan Tolgoi deposit during the period from November 2016 to February 2017. In February 2017, the Company has completed the mining operations at the Tavan Tolgoi deposit equivalent to MNT 20.3 billion (approximately $8.1 million) as set out in the agreement with Erdenes.

As at September 30, 2017, the Company is required to make further cash payments of $2.0 million during 2017 to complete repayment of the balance of the penalty owing. The decrease from the initial $18.0 million owing as at June 30, 2015 is as a result of subsequent transfers from frozen bank accounts of $1.2 million, additional cash payments by the Company of $3.4 million, the provision of mining services at the Tavan Tolgoi deposit of $8.1 million and the foreign exchange adjustments.

As described above, the Company is working with the relevant authorities in Mongolia to resolve the dispute giving rise to the tax verdict in a manner that is appropriate having regard to the Company's limited financial resources and supportive of a positive environment for foreign investment in Mongolia. Should the Company fail to meet the terms of the agreed repayment plan and to receive a discharge of the judgment from the applicable Mongolian court, this may result in an event of default under the CIC Convertible Debenture and CIC would have the right 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 pay the penalty could result in voluntary or involuntary proceedings involving the Company, including bankruptcy.

Mongolian IAAC investigation

In the first quarter of 2013, the Company was subject to orders imposed by the IAAC which placed restrictions on certain of the Company’s Mongolian assets. The orders were imposed on the Company in connection with the IAAC’s investigations of the Company as described under the section entitled "Governmental and Regulatory Investigations" above and continued to be enforced by the Mongolian State Investigation Office. The restrictions on the assets were reaffirmed in the tax verdict and form part of the Tax Penalty payable by the Company.

The orders related to certain items of operating equipment and infrastructure and the Company’s Mongolian bank accounts. The orders related to the operating equipment and infrastructure restricts the sale of these items; however, the orders do not restrict the use of these items in the Company’s mining activities. The orders related to the Company’s Mongolian bank accounts restricted the use of in-country funds but did not have any material impact on the Company’s activities. The Restricted Funds were transferred to the CDIA as partial payment of the tax verdict in October and November 2015. See the section entitled "Governmental and Regulatory Investigations" above.

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

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 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.

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 intends to seek leave to appeal to the Supreme Court of Canada.

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 September 30, 2017 was not required.

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 had a duration of five years from commencement of the contract and provided 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 $18.5 million. At each reporting date, the Company assesses the agreement with Ejin Jinda and has determined it is not probable that these $18.5 million will be required to be paid. Accordingly, the Company has determined a provision for this matter as at September 30, 2017 was not required.

Mining Prohibition in Specified Areas Law

In July 2009, Mongolia promulgated the Law on Prohibiting Mineral Exploration and Extraction Near Water Sources, Protected Areas and Forests (the “Mining Prohibition in Specified Areas Law”). Pursuant to the Mining Prohibition in Specified Areas Law, the Government of Mongolia has defined the boundaries of certain areas in which exploration and mining is purportedly prohibited. A list of licenses was prepared that overlap with the prohibited areas described in the law based on information submitted by water authority agencies, forest authority agencies and local authorities for submission to the Government of Mongolia.

In order to address the issues facing its implementation, in February 2015 the Parliament of Mongolia adopted an amendment to the Law on Implementation of the Mining Prohibition in Specified Areas Law (the “Amended Law on Implementation”). The Amended Law on Implementation provided an opportunity for license holders covered within the scope of application of the Mining Prohibition in Specified Areas Law to continue their mining operations subject to advance placement of funds to cover 100% of the future environmental rehabilitation costs. A model contract and a specific Government regulation on this requirement will be adopted by the Government. The license holders were required to apply within 3 months after the amendment to the Law on Implementation came into effect for permission to the Mineral Resources Authority of Mongolia to resume activities. The Company considered the development projects may be affected, but not the operating mines. The Company submitted its application with respect to its mining licenses before the deadline set on June 16, 2015.

Pursuant to the Mongolian Law “To prohibit mineral exploration and mining operations at headwaters of rivers, water protection zones and forested areas”, the government administrative agency has notified the Company that special license area 12726A is partly overlapping with a water reservoir. The Company has inspected the area together with the Cadastral Division of the Mineral Resource Authority as well as through the cadastral registration system of the Ministry of Environment, and determined that 29 hectares of Sukhait Bulag was partly overlapping with a water reservoir, of which has been partly handed over. (Resolution No.6/7522 issued on September 29, 2015 by the Head of Cadastral Division of the Mineral Resource Authority).

In accordance with Article 22.3 of Law of Mongolia on Water, 5,602.96 hectares of land, including Sukhaityn Bulag, Uvur Zadgai, and Zuun Shand pertaining to exploration license 9443X, which was converted to mining license MV-0125436 in January 2016, was overlapping with protected area boundary. It has been officially handed over to the local administration. (Resolution No.688 issued on September 24, 2015 by the Head of Cadastral Division of the Mineral Resource Authority). In connection with the nullification of Annex 2 of government order No.194 “On determining boundary” issued on June 5, 2012, the area around the water reservoir located at MV-016869 license area and Soumber exploration license 9449X, which was converted to mining license MV-020451 in January 2016, was annulled from the Specified Area Law.

Therefore, mining licenses 12726A and MV-016869 and exploration licenses 9443X and 9449X were removed from the list of licenses that overlaps with the prohibited areas described in the law.
Areas specified in all 6 of the Company's mining licenses do not overlap with any areas provided in the "Law on prohibition of mineral exploration and mining operations at headwaters of rivers, water protection zones and forested areas" as referenced in No.194 Resolution dated 2012 and No.289 Resolution dated 2015 of the Government of Mongolia.

There has been limited development of the law since 2016 while two exploration licenses of the Company (13779X and 5267X) were converted to mining licenses (MV-020676 and MV-020675) in November 2016. The Company will continue to monitor the developments and ensure that it follows the necessary steps in the Amended Law on Implementation to secure its operations and licenses and is fully compliant with Mongolian law.

Special Needs Territory in Umnugobi

On February 13, 2015, the entire Soumber mining license and a portion of SGS' exploration license 9443X (9443X was converted to mining license MV-020436 in January 2016) (the “License Areas”) were included into a special protected area (to be further referred as Special Needs Territory, the “SNT”) newly set up by the Umnugobi Aimag’s Civil Representatives Khural (the “CRKh”) to establish a strict regime on the protection of natural environment and prohibit mining activities in the territory of the SNT.

On July 8, 2015, SGS and the Chairman of the CRKh, in his capacity as the respondent’s representative, reached an agreement (the “Amicable Resolution Agreement”) to exclude the License Areas from the territory of the SNT in full, subject to confirmation of the Amicable Resolution Agreement by the session of the CRKh. The parties formally submitted the Amicable Resolution Agreement to the appointed judge of the Administrative Court for her approval and requested a dismissal of the case in accordance with the Law of Mongolia on Administrative Court Procedure. On July 10, 2015, the judge issued her order approving the Amicable Resolution Agreement and dismissing the case, while reaffirming the obligation of CRKh to take necessary actions at its next session to exclude the License Areas from the SNT and register the new map of the SNT with the relevant authorities. Mining activities at the Soumber property cannot proceed until the License Areas are removed from the SNT.

On June 29, 2016, the Mongolian Parliament and CRKh election was held. As a result, the Company was aware that additional action may be taken in respect of the SNT; however, the Company has not yet received any indication on the timing of the next session of the CRKh.

Commercial Arbitration in Hong Kong

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 $11.5 million. The arbitral proceedings (the “Arbitration”) are deemed to have commenced on June 24, 2015, as of the date when the respondent received the Notice.

The Company firmly rejected the allegations of First Concept in the Notice as lacking any merit. The Arbitration was held in the fourth quarter of 2016 and the decision has not been released as of the date hereof.

There can be no assurance, however, that the Company will prevail in the Arbitration. Should SGS be unsuccessful in the Arbitration, the Company may not be able to repay the sum of $11.5 million. In such case, this may result in an event of default under the CIC Convertible Debenture and CIC would have the right 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 repay the sum of $11.5 million to First Concept could result in voluntary or involuntary proceedings involving the Company (including bankruptcy).

Settlement of Lawsuit Notice from a Former Fuel Supplier

On June 30, 2017, the Company signed the Triparty Settlement Agreement with Magnai Trade LLC (“MTLLC”), a former fuel supplier of SGS, and ICIC pursuant to which: (i) MTLLC transferred to ICIC its right to receive payment from the Company of $8.0 million (the “Outstanding Amount”) owing under the settlement agreement dated February 10, 2017 between the Company and MTLLC and its right to enforce the arbitration award against the Company in connection therewith; and (ii) the Company and ICIC agreed to a revised payment schedule for repayment of the Outstanding Amount. Pursuant to the Triparty Settlement Agreement, the Company will pay interest on the Outstanding Amount, which shall accrue at a monthly rate of 1.8% and will be settled on a monthly basis. The Company is required to repay on average $1.3 million monthly during the period from July 2017 to November 2017 pursuant to the Triparty Settlement Agreement. To date, the Company has made all payments due under the Triparty Settlement Agreement.

TRANSPORTATION INFRASTRUCTURE

On August 2, 2011, the State Property Committee of Mongolia awarded the tender to construct a paved highway from the Ovoot Tolgoi Mine to the Shivee Khuren Border Crossing (the “Paved Highway”) to consortium partners NTB LLC and SGS (together referred to as “RDCC LLC”). The Company has an indirect 40% interest in RDCC LLC through its Mongolian subsidiary SGS.

On October 26, 2011, RDCC LLC signed a concession agreement with the State Property Committee of Mongolia. RDCC LLC has the right to conclude a 17-year build, operate and transfer agreement under the Mongolian Law on Concessions.

On May 8, 2015, the commercial operation of the Paved Highway commenced. The Paved Highway has significantly increased the safety of coal transportation, reduced environmental impacts and improved efficiency and capacity of coal transportation. The toll rate was set at MNT 900 per tonne of coal (subsequently increased) as compared to MNT 1,500 as stated in the signed concession agreement between RDCC LLC and the State Property Committee of Mongolia.

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.

On February 4, 2017, the Board of RDCC LLC increased the toll rate from MNT 900 per tonne of coal to MNT 1,200, effective from March 1, 2017.

The Paved Highway has a carrying capacity in excess of 20 million tonnes of coal per year.

For the three and nine months ended September 30, 2017, RDCC LLC recognized toll fee revenue of $1.2 million (2016: $1.1 million) and $4.3 million (2016: $3.3 million), respectively.

OUTLOOK

The outlook for Mongolian coal exports remains dependent on the Chinese economy. Looking forward, the Company remains cautiously optimistic regarding the Chinese coal market, which is expected to continue stabilizing. However it is unclear as to when the delays in the custom clearance process the Company is experiencing at the Ceke border will be fully resolved. The Company continues to closely monitor the situation at the Ceke border.

The Company intends to improve its product mix by commencing coal washing operations in the fourth quarter of 2017 to beneficiate a portion of its lower grade and higher-ash content coal into washed coal products, in order to meet increasing market demand for higher quality coal. The construction of the washing facilities at Ovoot Tolgoi has commenced and the operation is expected to start in the fourth quarter of 2017.

The Company will continue to reach out to end customers in order to enhance the sales profile and revenue growth.

The Company remains well positioned in the market, with a number of key competitive strengths, including:

- Bridge between Mongolia and China – The Company is well positioned to capture the resulting business opportunities between the two countries given: (i) strong strategic support from its largest shareholders (CIC and Cinda (Novel Sunrise’s parent company)), which are both state-owned-enterprises in China; and (ii) the Company has a strong operational record for ten years in Mongolia, being one of the largest enterprises in the country.
- Strategic location – The Ovoot Tolgoi Mine is located approximately 40km from China, which represents the Company’s main coal market. The Company has an infrastructure advantage, being approximately 50km from a major Chinese coal distribution terminal with rail connections to key coal markets in China.
- Large resources and reserves base*–* As a result of work performed by Dragon Mining Consulting Limited, the Company increased its estimate of total measured resources, indicated resources and inferred resources at the Ovoot Tolgoi deposit as of December 31, 2016 to 201.9 million tonnes (“Mt”), 100.3 Mt and 89.0 Mt, respectively. Further, the Company has declared proven reserves and probable reserves for the Ovoot Tolgoi deposit of 99.5 Mt and 14.6 Mt, respectively.
- Several growth options – The Company has several growth options including the Soumber Deposit and Zag Suuj Deposit, located approximately 20km east and approximately 150km east of the Ovoot Tolgoi Mine, respectively.

Objectives

The Company’s objectives for 2017 and the medium term are as follows:

- Enhance product mix – The Company is committed to enhancing the product quality by completing the construction and commissioning of the new wash plant, and completing a study of refurbishing, completing and implementing certain components of the former dry coal handling facility, which would enable the processing of lower grade coal into higher margin products on a larger scale.

- Expand customer base – The Company aims to strengthen its sales and logistics capabilities to expand the customer base further inland in China.
- Optimize cost structure – The Company is focused on further cost reduction by improving productivity and operational efficiency with the engagement of third party contract mining companies while maintaining product quality and the sustainability of production.
- Progress growth options – Subject to available financial resources, the Company plans to further the development of the Soumber Deposit, while staying compliant with all government requirements in relation to its licenses and agreements.
- Diversify the risk profile of the Company – The Company is evaluating various business opportunities besides coal mining, coal trading and real estate in Mongolia including, but not limited to, the Ceke Logistics Park, power generation and contract mining.
- Operate in a socially responsible manner – The Company is focused on maintaining the highest standards in health, safety and environmental performance.

NON-IFRS FINANCIAL MEASURES

Cash Costs

The Company uses cash costs to describe its cash production and associated cash costs incurred in bringing the inventories to their present locations and conditions. Cash costs incorporate all production costs, which include direct and indirect costs of production, with the exception of idled mine asset costs and non-cash expenses which are excluded. Non-cash expenses include share-based compensation expense, impairments of coal stockpile inventories, depreciation and depletion of property, plant and equipment and mineral properties. The Company uses this performance measure to monitor its operating cash costs internally and believes this measure provides investors and analysts with useful information about the Company’s underlying cash costs of operations. The Company believes that conventional measures of performance prepared in accordance with IFRS do not fully illustrate the ability of its mining operations to generate cash flows. The Company reports cash costs on a sales basis. This performance measure is commonly utilized in the mining industry.

Summarized Comprehensive Income Information
(Expressed in thousands of USD, except for share and per share amounts)

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Revenue	$ 19,356	$ 16,379	$ 79,275	$ 39,467
Cost of sales	(25,049)	(22,018)	(76,193)	(64,203)
Gross profit/(loss)	(5,693)	(5,639)	3,082	(24,736)
Other operating income/(expenses)	3,477	4,631	(3,776)	3,732
Administration expenses	(2,451)	(2,042)	(7,070)	(5,510)
Evaluation and exploration expenses	(48)	(101)	(221)	(200)
Loss from operations	(4,715)	(3,151)	(7,985)	(26,714)
Finance costs	(5,674)	(6,358)	(16,708)	(16,910)
Finance income	142	5	21	8
Share of earnings of a joint venture	265	89	919	428
Loss before tax	(9,982)	(9,415)	(23,753)	(43,188)
Current income tax credit/(expense)	238	82	(2,521)	(176)
Net loss attributable to equity holders of the Company	(9,744)	(9,333)	(26,274)	(43,364)
Other comprehensive income/(loss) to be reclassified to profit or loss in subsequent periods				
Exchange difference on translation of foreign operation	(756)	(2,892)	187	(2,525)
Net comprehensive loss attributable to equity holders of the Company	$ (10,500)	$ (12,225)	$ (26,087)	$ (45,889)

Basic and diluted loss per share	$ (0.04)	$ (0.04)	$ (0.10)	$ (0.17)

Summarized Financial Position Information
(Expressed in thousands of USD)

	As at September 30, 2017	December 31, 2016
Assets		
Current assets		
Cash and cash equivalents	$ 2,162	$ 966
Trade and other receivables	11,052	19,434
Properties held for sale	9,677	-
Inventories	43,857	28,583
Prepaid expenses and deposits	10,774	8,194
Total current assets	77,522	57,177
Non-current assets		
Property, plant and equipment	160,412	180,809
Investment in a joint venture	20,887	21,335
Total non-current assets	181,299	202,144
Total assets	$ 258,821	$ 259,321
Equity and liabilities		
Current liabilities		
Trade and other payables	$ 74,956	$ 43,628
Provision for court case penalty	2,029	9,074
Deferred revenue	31,725	29,849
Interest-bearing borrowings	7,226	8,454
Current portion of convertible debenture	21,238	25,597
Total current liabilities	137,174	116,602
Non-current liabilities		
Interest-bearing borrowings	482	425
Convertible debenture	92,196	91,993
Decommissioning liability	4,939	4,288
Total non-current liabilities	97,617	96,706
Total liabilities	234,791	213,308
Equity		
Common shares	1,098,621	1,094,619
Share option reserve	52,442	52,340
Exchange reserve	(4,971)	(5,158)
Accumulated deficit	(1,122,062)	(1,095,788)
Total equity	24,030	46,013
Total equity and liabilities	$ 258,821	$ 259,321
Net current liabilities	$ (59,652) .	$ (59,425)
Total assets less current liabilities	$ 121,647	$ 142,719

REVIEW OF INTERIM RESULTS

The condensed consolidated interim financial statements of the Company for the three and nine months ended September 30, 2017, which are unaudited but have been reviewed by the Company’s independent auditor and the Audit Committee of the Company.

The Company’s results for the three and nine months ended September 30, 2017 are contained in the unaudited Condensed Consolidated Interim Financial Statements and Management Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”), available on the SEDAR website at www.sedar.com and the Company’s website at www.southgobi.com.

ABOUT SOUTHGOBI

SouthGobi, listed on the Toronto and Hong Kong stock exchanges, owns and operates its ﬂagship Ovoot Tolgoi coal mine in Mongolia. It also holds the mining licences of its other metallurgical and thermal coal deposits in South Gobi Region of Mongolia. SouthGobi produces and sells coal to customers in China.

Forward-Looking Statements: Except for statements of fact relating to the Company, certain information contained herein constitutes forward-looking statements. Forward-looking statements are frequently characterized by words such as “plan”, “expect”, “project”, “intend”, “believe”, “anticipate”, "could", "should", "seek", "likely", "estimate" and other similar words or statements that certain events or conditions “may” or “will” occur. Forward-looking statements relate to management’s future outlook and anticipated events or results and are based on the opinions and estimates of management at the times the statements are made. Forward-looking statements in this announcement include, but are not limited to, statements regarding:

- the Company continuing as a going concern and its ability to realize its assets and discharge its liabilities in the normal course of operations as they become due; adjustments to the amounts and classifications of assets and liabilities in the Company's consolidated financial statements and the impact thereof;
- the Company’s expectations of sufficient liquidity and capital resources to meet its ongoing obligations and future contractual commitments, including the Company’s ability to settle its trade payables, to secure additional funding and to meet its obligations under each of the CIC Convertible Debenture, the TRQ Loan, the equipment loan and the bank loan, as the same become due;
- the Company's anticipated financing needs, development plans and future production levels;
- the ability of the Company to satisfy the balance of the outstanding Tax Penalty;
- the ability of the Company to negotiate favorable repayment terms on the TRQ Reimbursable Amount;
- the ability of the Company to meet the repayment terms as per the Triparty Settlement Agreement with ICIC;
- the potential consequence to the Company if the judicial order in relation to the settlement agreement with MTLLC is taken to a bailiff service by ICIC;
- the outcome of arbitration proceedings involving the Company and First Concept with respect to a coal supply agreement and payments thereunder;
- the results and impact of the Ontario class action;
- the estimates and assumptions included in the Company’s impairment analysis and the possible impact of changes thereof;
- the agreement with Ejin Jinda and the payments thereunder;
- the commencement of the washing facilities at Ovoot Tolgoi and the timing thereof;
- the ability to enhance the product value by conducting coal processing and coal washing;
- the development of the Ceke Logistics Park project;
- the Company’s expectation that it will be unable to pay the November 19th Payments to CIC on the due date;
- the Company successfully negotiating a deferral of the $17.8 million payments due on November 19, 2017 to CIC under the June 2017 Deferral Agreement and CIC Convertible Debenture;
- the Company's intention to develop markets for its semi-soft coking coal brands and to pursue long-term supply offtake agreements with end users in China;
- the evaluation, and potential pursuit of, business opportunities other than coal mining, coal trading and real estate in Mongolia, including but not limited to the Ceke Logistics Park, power generation and contract mining;
- the impact of the Company’s activities on the environment and actions taken for the purpose of mitigation of potential environmental impacts and planned focus on health, safety and environmental performance;
- the Company’s objectives for 2017 and beyond; and
- other statements that are not historical facts.

Forward-looking information is based on certain factors and assumptions described below and elsewhere in this announcement, including, among other things: the current mine plan for the Ovoot Tolgoi mine; mining, production, construction and exploration activities at the Company’s mineral properties; the costs relating to anticipated capital expenditures and the 2017 exploration program; the expected impacts of the remaining administrative restrictions on certain of the Company's Mongolian assets and the anticipated impact on the Company's activities; the capacity and future toll rate of the paved highway; plans for the progress of mining license application processes; mining methods; the Company's anticipated business activities, planned expenditures and corporate strategies; management’s business outlook, including the outlook for the remainder of 2017 and beyond; currency exchange rates; operating, labour and fuel costs, the future coal market conditions in China and the related impact on the Company’s margins and liquidity; future coal prices, and the level of worldwide coal production. While the Company considers these assumptions to be reasonable based on the information currently available to it, they may prove to be incorrect. Forward-looking statements are subject to a variety of risks and uncertainties and other factors that could cause actual events or results to differ materially from those projected in the forward-looking statements. These risks and uncertainties include, among other things: the uncertain nature of mining activities, risks associated with joint venture operations; actual capital and operating costs exceeding management’s estimates; variations in mineral resource and mineral reserve estimates; failure of plant, equipment or processes to operate as anticipated; the possible impacts of changes in mine life, useful life or depreciation rates on depreciation expenses; risks associated with regulatory requirements and the ability to obtain all necessary regulatory approvals; the potential expansion of the list of licenses published by the Government of Mongolia covering areas in which exploration and mining are purportedly prohibited on certain of the Company's mining licenses; the Government of Mongolia designating any one or more of the Company’s mineral projects in Mongolia as a Mineral Deposit of Strategic Importance; continued delays in the custom clearance process at the Ceke border; the possible impact of changes to the inputs to the valuation model used to value the embedded derivatives in the CIC Convertible Debenture; risk of the Company defaulting under its existing debt obligations, including the CIC Convertible Debenture, the TRQ Loan, equipment loan and bank loan; the impact of amendments to, or the application of, the laws of Mongolia, China and other countries in which the Company carries on business; modifications to existing practices so as to comply with any future permit conditions that may be imposed by regulators; delays in obtaining approvals and lease renewals; the risk of fluctuations in coal prices and changes in China and world economic conditions; risk of the tax verdict becoming immediately payable; the outcome of the Class Action and any damages payable by the Company as a result; the outcome of the arbitration proceedings with First Concept and any payments payable by the Company resulting therefrom; cash flow and liquidity risks; risks relating to the Company’s ability to raise additional financing and to continue as a going concern. Please see the Company’s most recently filed Annual Information Form for the year ended December 31, 2016, which is available under the Company’s profile on SEDAR at www.sedar.com, for a discussion of these and other risks and uncertainties relating to the Company and its operations.

This list is not exhaustive of the factors that may affect any of the Company’s forward-looking statements.

Due to assumptions, risks and uncertainties, including the assumptions, risks and uncertainties identified above and elsewhere in this announcement, actual events may differ materially from current expectations. The Company uses forward-looking statements because it believes such statements provide useful information with respect to the currently expected future operations and financial performance of the Company, and cautions readers that the information may not be appropriate for other purposes. Except as required by law, the Company undertakes no obligation to update forward-looking statements if circumstances or management’s estimates or opinions should change. The reader is cautioned not to place undue reliance on the forward-looking statements, which speaks only as of the date of this announcement; they should not rely upon this information as of any other date.

The English text of this announcement shall prevail over the Chinese text in case of inconsistencies.

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