

# SouthGobi Resources announces first quarter 2018 financial and operating results

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HONG KONG, May 14, 2018 (GLOBE NEWSWIRE) -- [SouthGobi Resources Ltd.](#) (TSX:SGQ) (HK:1878) (the "Company" or "SouthGobi") today announces its financial and operating results for the three months ended March 31, 2018. 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 March 31, 2018 and the subsequent period to May 14, 2018 are as follows:

- **Operating Results** – As a result of improved market conditions and prices for coal in China as well as a higher portion of sales were made through our Inner Mongolia subsidiary, the Company experienced an increase in the average selling price of coal from \$24.52 per tonne in the first quarter of 2017 to \$43.02 per tonne in the first quarter of 2018. However, the volume of coal sales has decreased from 1.11 million tonnes in the first quarter of 2017 to 0.56 million tonnes in the first quarter of 2018 as a result of the delay in the customs clearance process at the Ceke border which the Company has been experiencing since July 2017.
- **Financial Results** – The Company recorded a gross profit of \$6.7 million in the first quarter of 2018 compared to \$1.5 million in the first quarter of 2017 while \$2.9 million profit from operations was recorded in the first quarter of 2018 compared to a \$4.1 million loss from operations in the first quarter of 2017. As a result of improved market conditions and prices for coal in China, the overall financial results improved when compared to the first quarter of 2017, which was principally attributable to the higher average selling price achieved during the quarter.

- *China Investment Corporation (&ldquo;CIC&rdquo;)* convertible debenture (&ldquo;CIC Convertible Debenture&rdquo;) &ndash; Pursuant to the terms of the deferral agreement dated June 12, 2017 (the &ldquo;June 2017 Deferral Agreement&rdquo;) 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 &ldquo;May 2017 Interest Payable&rdquo;), the Company was required to pay \$9.7 million of cash interest and associated costs to CIC on November 19, 2017 (the &ldquo;June 2017 Deferral Agreement Payment&rdquo;). In addition, pursuant to the terms of the CIC Convertible Debenture, the Company was required to pay \$8.1 million of anniversary cash interest to CIC on November 19, 2017 (the &ldquo;November Interest Payment&rdquo; and together with the June 2017 Deferral Agreement Payment, the &ldquo;November 19<sup>th</sup> Payments&rdquo;). Pursuant to the CIC Convertible Debenture, the Company was also obliged to issue \$4.0 million worth of PIK interest shares (the &ldquo;November 2017 PIK Interest&rdquo;) to CIC on November 19, 2017.

As of the date of this press release, the Company: (i) has neither paid the November 19<sup>th</sup> Payments nor issued the November 2017 PIK Interest shares to CIC within the cure period provided for under 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. In addition, pursuant to the terms of the CIC Convertible Debenture, the Company is required to pay \$7.9 million of cash interest to CIC on May 19, 2018 (the &ldquo;May 2018 Payment&rdquo;). As of the date of this press release, the Company expects that it will be unable to pay the May 2018 Payment to CIC on the due date. Pursuant to the terms of the CIC Convertible Debenture and the June 2017 Deferral Agreement, CIC may, at 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 of this press release, 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.

The Company is in discussion with CIC for a deferral of the November 19<sup>th</sup> Payments, the November 2017 PIK Interest and the May 2018 Payment; however, there can be no assurance that a favorable outcome will be reached.

As a consequence of the Company not entering into a deferral agreement with CIC as at March 31, 2018, International Accounting Standard (&ldquo;IAS&rdquo;) 1 requires the Company to classify the entire balance of the CIC Convertible Debenture as a current liability as at March 31, 2018, notwithstanding the fact that CIC has not indicated any intention to deliver notice of default or accelerate the maturity of the CIC Convertible 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.

- *Notice of Arbitration* – On January 10, 2018, the Company received a confidential partial award (final except as to costs) (the “Arbitration Award”) with respect to an arbitration proceeding in Hong Kong related to a dispute concerning a coal supply agreement between SouthGobi Sands LLC (“SGS”), a subsidiary of the Company, and First Concept Industrial Group Limited (“First Concept”).

Pursuant to the Arbitration Award, SGS has been ordered to repay the sum of \$11.5 million (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 March 31, 2018, the Company recorded a provision of \$14.1 million for the commercial arbitration.

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.

The Company is currently considering and reviewing its options with respect to the Arbitration Award, including exploring ways to work together 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.

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.

- *Termination of Enforcement Procedures relating to Tax Verdict* - Following the termination of enforcement procedures in relation to the previously disclosed judgment of the Mongolian Second Criminal Court rendered against SGS (the “Tax Verdict”) in January 2018, the dispute giving rise to the Tax Verdict has been fully resolved. The Company will continue to work closely with the Mongolian authorities to ensure compliance with all applicable Mongolian rules and regulations.
- *Changes in Directors*

*Mr. Zhiwei Chen:* Mr. Chen was appointed as a non-executive director on April 13, 2018.

*Mr. Xiaoxiao Li:* Mr. Li was appointed as a non-executive director on April 13, 2018.

- *Going Concern &ndash;* 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 commencing the washing of certain grades of coal in order to produce more premium semi-soft coking coal upon the successful commissioning of the coal washing facility under construction at the mine 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, the commencement of washing has been delayed to the second 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 March 31, 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 condensed consolidated interim 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" of this press release for details. As at May 14, 2018, the Company had \$2.1 million of cash.

## OVERVIEW OF OPERATIONAL DATA AND FINANCIAL RESULTS

### Summary of Operational Data

	Three months ended March 31,	
	2018	2017
Sales Volumes, Prices and Costs		
Premium semi-soft coking coal		
Coal sales ( <i>millions of tonnes</i> )	0.03	0.19
Average realized selling price ( <i>per tonne</i> ) <sup>(i)</sup>	\$ 67.94	\$ 45.61
Standard semi-soft coking coal/ premium thermal coal		
Coal sales ( <i>millions of tonnes</i> )	0.41	0.64
Average realized selling price ( <i>per tonne</i> ) <sup>(i)</sup>	\$ 46.34	\$ 23.36
Standard thermal coal		
Coal sales ( <i>millions of tonnes</i> )	0.12	0.28
Average realized selling price ( <i>per tonne</i> ) <sup>(i)</sup>	\$ 25.40	\$ 13.17
Total		
Coal sales ( <i>millions of tonnes</i> )	0.56	1.11
Average realized selling price ( <i>per tonne</i> ) <sup>(i)</sup>	\$ 43.02	\$ 24.52
Raw coal production ( <i>millions of tonnes</i> )		
	0.38	1.51
Cost of sales of product sold ( <i>per tonne</i> )		
	\$ 29.48	\$ 21.40
Direct cash costs of product sold ( <i>per tonne</i> ) <sup>(ii)</sup>		
	\$ 16.86	\$ 9.42
Mine administration cash costs of product sold ( <i>per tonne</i> ) <sup>(iii)</sup>		
	\$ 1.23	\$ 1.01
Total cash costs of product sold ( <i>per tonne</i> ) <sup>(iii)</sup>		
	\$ 18.09	\$ 10.43
Other Operational Data		
Production waste material moved ( <i>millions of bank cubic meters</i> )	2.88	3.30

Strip ratio ( <i>bank cubic meters of waste material per tonne of coal produced</i> )	7.55	2.18
Lost time injury frequency rate <sup>(iii)</sup>	0.13	0.11

(i) Average realized selling price is presented before deduction of royalties.

(ii) A Non-International Financial Reporting Standards (&ldquo;IFRS&rdquo;) financial measure, which does not have a standardized meaning according to IFRS. See &ldquo;Non-IFRS Financial Measures&rdquo; 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

As at March 31, 2018, the Company had a lost time injury frequency rate of 0.13 per 200,000 man hours based on a rolling 12 month average.

As a result of improved market conditions and prices for coal in China as well as a higher portion of sales were made through our Inner Mongolia subsidiary, the average realized selling price increased from \$24.52 per tonne in the first quarter of 2017 to \$43.02 per tonne in the first quarter of 2018. The product mix for the first quarter of 2018 consisted of approximately 6% of premium semi-soft coking coal, 72% of standard semi-soft coking coal/premium thermal coal and 22% of standard thermal coal compared to approximately 17% of premium semi-soft coking coal, 58% of standard semi-soft coking coal/premium thermal coal and 25% of standard thermal coal in the first quarter of 2017.

The Company sold 0.56 million tonnes for the first quarter of 2018 as compared to 1.11 million tonnes for the first quarter of 2017, as a result of the delay in the customs clearance process at the Ceke border which the Company has been experiencing since July 2017.

The Company's production in the first quarter of 2018 was lower than the first quarter of 2017 as a result of pacing the production to meet the expected sales, yielding 0.38 million tonnes for the first quarter of 2018 as compared to 1.51 million tonnes for the first quarter of 2017.

The Company's unit cost of sales of product sold increased to \$29.48 per tonne in the first quarter of 2018 from \$21.40 per tonne in the first quarter of 2017. The increase was mainly driven by decreased sales and the related diseconomies of scale.

## Summary of Financial Results

<i>\$ in thousands, except per share information</i>	Three months ended	
	March 31,	
	2018	2017
Revenue <sup>(i),(ii)</sup>	\$ 23,223	\$ 25,254
Cost of sales <sup>(ii)</sup>	(16,507 )	(23,759 )
Gross profit excluding idled mine asset costs	10,250	4,714
Gross profit including idled mine asset costs	6,716	1,495
Other operating expenses	(1,338 )	(3,208 )
Administration expenses	(2,377 )	(2,385 )
Evaluation and exploration expenses	(124 )	(29 )
Profit/(loss) from operations	2,877	(4,127 )
Finance costs	(6,006 )	(5,715 )
Finance income	258	4
Share of earnings of a joint venture	340	266
Income tax expense	(929 )	(45 )
Net loss	(3,460 )	(9,617 )

Basic and diluted loss per share                      \$ (0.01 ) \$ (0.04 )

(i) Revenue is presented after the deduction of royalties.

(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 financial statements for further analysis regarding the Company's reportable operating segments.

## Overview of Financial Results

The Company recorded a \$2.9 million profit from operations in the first quarter of 2018 compared to a \$4.1 million loss from operations in the first quarter of 2017. As a result of improved market conditions and prices for coal in China, the overall financial results improved when compared to the first quarter of 2017, which were principally attributable to higher average selling price achieved during the quarter.

Revenue was \$23.2 million in the first quarter of 2018 compared to \$25.3 million in the first quarter of 2017. The Company's revenue is presented after deduction of royalties. The Company's effective royalty rate for the first quarter of 2018, based on the Company's average realized selling price of \$43.02 per tonne, was 5.0% or \$2.13 per tonne compared to 5.9% or \$1.44 per tonne based on the average realized selling price of \$24.52 per tonne in the first quarter of 2017.

## 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, customs 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. See the section entitled "Risk Factors - Company's Projects in Mongolia" in the Company's most recently filed Annual Information Form for the year ended December 31, 2017, a copy of which is available under the Company's profile on SEDAR at [www.sedar.com](http://www.sedar.com).

Cost of sales was \$16.5 million in the first quarter of 2018 compared to \$23.8 million in the first quarter of 2017. The decrease in cost of sales was mainly due to the decreased sales during the quarter. 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 (see section "Non-IFRS financial measure" of this press release for further analysis) during the quarter.

\$ in thousands	Three months ended March 31,	
	2018	2017
Operating expenses	\$ 10,132	\$ 10,700
Share-based compensation expense	-	23
Depreciation and depletion	2,841	7,486
Impairment of coal stockpile inventories	-	2,331
Cost of sales from mine operations	12,973	20,540
Cost of sales related to idled mine assets	3,534	3,219
Cost of sales	\$ 16,507	\$ 23,759

Operating expenses in cost of sales were \$10.1 million in the first quarter of 2018 compared to \$10.7 million

in the first quarter of 2017. The overall decrease in operating expenses was primarily due to the net effect of: (i) decreased sales volume from 1.11 million tonnes in the first quarter of 2017 to 0.56 million tonnes in the first quarter of 2018 and (ii) less coal stockpile inventories were impaired during the quarter which increased the inventory cost.

There was no impairment of coal stockpiles for the first quarter of 2018 (first quarter of 2017: \$2.3 million). The coal stockpile impairments recorded in the first quarter of 2017 primarily related to the Company's higher-ash content products.

Cost of sales related to idled mine asset costs primarily consisted of periodic costs, which were expensed as incurred and included mainly depreciation expense. Cost of sales related to idled mine assets in the first quarter of 2018 included \$3.5 million related to depreciation expenses for idled equipment (first quarter of 2017: \$3.2 million).

Other operating expenses was \$1.3 million in 2018 (first quarter of 2017: \$3.2 million).

<i>\$ in thousands</i>	Three months ended March 31,	
	2018	2017
Provision for doubtful trade and other receivables	\$ (1,103 )	\$ -
Foreign exchange gain/(loss)	779	(510 )
CIC management fee	(583 )	-
Penalty on late settlement of trade payables	(104 )	(268 )
Loss on disposal of property, plant and equipment	(67 )	-
Provision for commercial arbitration	(224 )	-
Mining services, net	-	(2,395 )
Other	(36 )	(35 )
Other operating expenses	\$ (1,338 )	\$ (3,208 )

The Company made a provision for doubtful trade and other receivables of \$1.1 million in the first quarter of 2018 (first quarter of 2017: nil) for certain long aged receivables based on expected credit loss model upon the adoption of the IFRS 9.

A foreign exchange gain of \$0.8 million was recorded during the first quarter of 2018 (first quarter of 2017: a foreign exchange loss of \$0.5 million) as a result of the significant appreciation of RMB against USD. The key underlying driver of the forex gain are that most trade receivables are denominated in RMB.

Administration expenses were \$2.4 million for both the first quarter of 2018 and first quarter of 2017.

<i>\$ in thousands</i>	Three months ended March 31,	
	2018	2017
Corporate administration	\$ 668	\$ 470
Professional fees	515	918
Salaries and benefits	1,134	843
Share-based compensation expense	16	11
Depreciation	44	143
Administration expenses	\$ 2,377	\$ 2,385

The increase in salaries and benefits was mainly due to the increase of headcount, which is to support the expansion of the sales channel in China.

Evaluation and exploration expenses were \$0.1million in the first quarter of 2018 (first quarter of 2017: negligible). The Company continued to minimize evaluation and exploration expenditures in 2018 in order to preserve the Company's financial resources. Evaluation and exploration activities and expenditures in

the first quarter of 2018 were limited to ensuring that the Company met the Mongolian Minerals Law requirements in respect of its mining licenses.

Finance costs were \$6.0 million and \$5.7 million in the first quarter of 2018 and 2017 respectively, which primarily consisted of interest expense on the \$250.0 million CIC Convertible Debenture.

Finance income was \$0.3 million for the first quarter of 2018 (first quarter of 2017: negligible), which primarily related to fair value gain on notes receivable upon redemption.

#### Summary of Quarterly Operational Data

Quarter Ended	2018		2017		2016		
	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec	30-Sep
<b>Sales Volumes, Prices and Costs</b>							
<b>Premium semi-soft coking coal</b>							
Coal sales ( <i>millions of tonnes</i> )	0.03	0.37	0.12	0.18	0.19	0.15	0.07
Average realized selling price ( <i>per tonne</i> ) <sup>(i)</sup>	\$ 67.94	\$ 50.47	\$ 46.55	\$ 45.67	\$ 45.61	\$ 40.49	\$ 21.00
<b>Standard semi-soft coking coal/ premium thermal coal</b>							
Coal sales ( <i>millions of tonnes</i> )	0.41	0.60	0.41	0.79	0.64	0.65	0.77
Average realized selling price ( <i>per tonne</i> ) <sup>(i)</sup>	\$ 46.34	\$ 37.49	\$ 28.32	\$ 26.69	\$ 23.36	\$ 16.79	\$ 15.60
<b>Standard thermal coal</b>							
Coal sales ( <i>millions of tonnes</i> )	0.12	0.29	0.27	0.51	0.28	0.28	0.29
Average realized selling price ( <i>per tonne</i> ) <sup>(i)</sup>	\$ 25.40	\$ 16.98	\$ 14.48	\$ 15.79	\$ 13.17	\$ 15.26	\$ 14.70
<b>Total</b>							
Coal sales ( <i>millions of tonnes</i> )	0.56	1.26	0.80	1.48	1.11	1.08	1.13
Average realized selling price ( <i>per tonne</i> ) <sup>(i)</sup>	\$ 43.02	\$ 36.54	\$ 26.41	\$ 25.24	\$ 24.52	\$ 19.55	\$ 15.70
<b>Raw coal production (<i>millions of tonnes</i>)</b>							
Cost of sales of product sold ( <i>per tonne</i> )	\$ 29.48	\$ 23.54	\$ 31.31	\$ 18.50	\$ 21.40	\$ 21.15	\$ 19.50
Direct cash costs of product sold ( <i>per tonne</i> ) <sup>(ii)</sup>	\$ 16.86	\$ 9.91	\$ 10.98	\$ 7.84	\$ 9.42	\$ 7.97	\$ 7.13
Mine administration cash costs of product sold ( <i>per tonne</i> ) <sup>(ii)</sup>	\$ 1.23	\$ 4.92	\$ 2.98	\$ 2.22	\$ 1.01	\$ 3.23	\$ 2.26
Total cash costs of product sold ( <i>per tonne</i> ) <sup>(ii)</sup>	\$ 18.09	\$ 14.83	\$ 13.96	\$ 10.06	\$ 10.43	\$ 11.20	\$ 9.39
<b>Other Operational Data</b>							
Production waste material moved ( <i>millions of bank cubic meters</i> )	2.88	4.36	6.77	6.36	3.30	2.62	2.22
Strip ratio ( <i>bank cubic meters of waste material per tonne of coal produced</i> )	7.55	8.59	2.74	3.37	2.18	2.16	1.96
Lost time injury frequency rate <sup>(iii)</sup>	0.13	0.20	0.23	0.18	0.11	0.00	0.00

(i) Average realized selling price is presented before deduction of royalties.

(ii) A non-IFRS financial measure, which does not have a standardized meaning according to IFRS. See section "Non-IFRS Financial Measures". 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 consolidated financial statements are reported under IFRS issued by the International Accounting Standards Board ("IASB"). The following table provides highlights from the Company's consolidated financial statements of quarterly results for the past eight quarters.



<i>\$ in thousands, except per share information</i>	2018	2017				2016
Quarter Ended	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec
<b>Financial Results</b>						
Revenue <i>(i), (ii)</i>	\$ 23,223	\$ 41,698	\$ 19,356	\$ 34,665	\$ 25,254	\$ 18,9
Cost of sales <i>(ii)</i>	(16,507 )	(29,665 )	(25,049 )	(27,385 )	(23,759 )	(22,8
Gross profit/(loss) excluding idled mine asset costs	10,250	15,682	(2,094 )	9,445	4,714	(2,35
Gross profit/(loss) including idled mine asset costs	6,716	12,033	(5,693 )	7,280	1,495	(3,85
Other operating income/(expenses)	(1,338 )	(7,488 )	3,477	(4,045 )	(3,208 )	(3,78
Administration expenses	(2,377 )	(2,111 )	(2,451 )	(2,234 )	(2,385 )	(2,37
Evaluation and exploration expenses	(124 )	(52 )	(48 )	(144 )	(29 )	(222
Impairment of property, plant and equipment	-	(11,171 )	-	-	-	(1,15
Profit/(loss) from operations	2,877	(8,789 )	(4,715 )	857	(4,127 )	(11,3
Finance costs	(6,006 )	(6,250 )	(5,674 )	(5,494 )	(5,715 )	(5,64
Finance income	258	143	142	50	4	472
Share of earnings of a joint venture	340	368	265	388	266	378
Income tax credit/(expense)	(929 )	781	238	(2,714 )	(45 )	(1,29
Net loss	(3,460 )	(13,747 )	(9,744 )	(6,913 )	(9,617 )	(17,4
Basic and diluted loss per share	\$ (0.01 )	\$ (0.05 )	\$ (0.04 )	\$ (0.03 )	\$ (0.04 )	\$ (0.07

(i) Revenue is presented after deduction of royalties.

(ii) Revenue and cost of sales relate to the Company's Ovoid Tolgoi Mine within the Coal Division operating segment. Refer to note 3 of the condensed consolidated 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.](#) (&ldquo;Turquoise Hill&rdquo;) Loan Facility (&ldquo;TRQ Loan&rdquo;)

On May 25, 2014, the Company announced it obtained the TRQ Loan in the form of a \$10 million revolving credit facility to meet its short term working capital requirements. The terms and conditions of this facility were filed on SEDAR ([www.sedar.com](http://www.sedar.com)) on June 2, 2014. 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 \$0.1 million.

During 2014 to 2016, the due date of the TRQ Loan, was extended several times and the maximum amount of the facility was reduced to \$3.8 million.

On May 16, 2016, the Company and Turquoise Hill entered into a deferral agreement (the &ldquo;May 2016 Deferral Agreement&rdquo;), 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:

- The Company agreed to effect monthly repayments on the last business day of each month in an amount of (i) \$0.15 million per month from May 2016 to April 2017; (ii) \$0.2 million 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 of this press release, 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. As of the date of this press release, the Company has received no indication from Turquoise Hill of any intention to demand payment of the amounts outstanding under the TRQ Loan and the May 2016 Deferral Agreement.

As at March 31, 2018, the outstanding principal and accrued interest under this facility amounted to \$0.8 million and \$0.7 million, respectively (December 31, 2017: the outstanding principal and accrued interest under this facility amounted to \$1.0 million and \$0.7 million, respectively). A fair value gain of \$0.1 million was credited to accumulated deficit upon the adoption of IFRS 9 starting from January 1, 2018.

### *Equipment Loan*

Inner Mongolia SouthGobi Energy Ltd., a subsidiary of the Company, executed a \$10.4 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 \$10.4 million;
- Maturity date set at 12 months from each drawdown;
- 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.

As at March 31, 2018, the outstanding principal for the equipment loan amounted to \$2.4 million (December 31, 2017: \$ 2.3 million) and the Company owed accrued interest of \$0.2 million (December 31, 2017: \$0.1 million).

A loan arrangement fee of 1% of the loan principal drawn was charged and will be amortized throughout the loan term. For the three months ended March 31, 2018, \$0.1 million 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 of the press release.

### *Bank Loan*

On May 6, 2016, SGS 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 matured 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 \$3.8 million as at March 31, 2018 were pledged as security.

As at March 31, 2018, the outstanding balance for the Bank Loan was \$3.0 million (December 31, 2017: \$3.0 million) and the Company owed accrued interest of \$0.1 million (December 31, 2017: \$0.1 million).

Subsequently in May 2018, \$2.3 million of the loan principal was repaid to the Bank by the Company.

#### *Costs reimbursable to Turquoise Hill*

Prior to the completion of the private placement with Novel Sunrise on April 23, 2015, [Rio Tinto Plc](#) (&ldquo;Rio Tinto&rdquo;) was the Company&rsquo;s ultimate parent company. In the past, Rio Tinto 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&rsquo;s prior internal investigation and Rio Tinto&rsquo;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 March 31, 2018, the amount of reimbursable costs and fees claimed by Turquoise Hill (the &ldquo;TRQ Reimbursable Amount&rdquo;) amounted to \$8.1 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 has been 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&rsquo;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 March 31, 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 \$175.5 million as at March 31, 2018 compared to \$166.3 million of working capital deficiency as at December 31, 2017. Included in the working capital deficiency at March 31, 2018 are significant obligations, which include obligation to pay CIC under the June 2017 Deferral Agreement in which the Company was required to pay \$9.7 million of cash interest and associated costs on November 19, 2017. In addition, pursuant to the terms of CIC Convertible Debenture, the Company was required to pay \$8.1 million of anniversary cash interest on November 19, 2017 and will be required to pay \$7.9 million of cash interest on May 19, 2018. The Company is in discussion with CIC for a deferral of the November 19<sup>th</sup> Payments and the May 2018 Payment; 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.

Pursuant to the Arbitration Award, SGS has been ordered to repay the sum of \$11.5 million 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 \$11.5 million 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 \$11.5 million and associated interest to First Concept could result in voluntary or involuntary proceedings involving the Company (including bankruptcy).

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 risen as compared to that as at December 31, 2017, as follows:

\$ in thousands	As at	
	March 31, 2018	December 31, 2017
Less than 1 month	\$ 18,762	\$ 20,664
1 to 3 months	15,414	16,132
3 to 6 months	14,556	8,825
Over 6 months	32,507	33,598
Total trade and other payables	\$ 81,239	\$ 79,219

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 May 14, 2018.

The Company also has other current liabilities, which require settlement in the short-term, including: the \$1.5 million undiscounted balance of the TRQ Loan; and the principal amount of equipment loan of \$2.3 million and associated interest due in August 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 second 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 March 31, 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 of this press release, 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, at 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 of this press release, 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 demand payment of the amounts outstanding under the TRQ Loan. In addition, SGS received 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. If First Concept is successful in enforcing the Arbitration Award, the Company may not be able to re-pay the sum of \$11.5 million and the associated interest. 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 the 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.

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 March 31, 2018, the Company's gearing ratio was 0.02 (December 31, 2017: 0.02), which was calculated based on the Company's long term liabilities to total assets. As at March 31, 2018 and December 31, 2017, the Company has not been subject to any externally imposed capital requirements.

As at May 14, 2018, the Company had \$2.1 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 March 31, 2018, 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 was 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 was 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.

In addition, pursuant to the terms of the CIC Convertible Debenture, the Company was required to pay \$8.1 million of anniversary cash interest to CIC on November 19, 2017. Pursuant to the Convertible Debenture, the Company was also obliged to issue \$4.0 million worth of November 2017 PIK Interest shares to CIC on November 19, 2017. The Company will also be required to pay \$7.9 million of cash interest to CIC on May 19, 2018. As of the date of this press release, the Company expects that it will be unable to pay the May 2018 Payment to CIC on the due date.

As of the date of this press release, the Company: (i) has neither paid the November 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, at 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 of this press release, 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.

The Company is in discussion with CIC for a deferral of the November 19<sup>th</sup> Payments, the November 2017 PIK Interest and the May 2018 Payment; however, there can be no assurance that a favorable outcome will be reached between CIC and the Company. CIC has notified the Company that, as a condition to agreeing to any deferral, 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. In addition, CIC has advised the Company that it is undertaking a review of the financial and operational performance of the Company. To the knowledge of the Company, this review remains on-going as of the date of this press release.

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 March 31, 2018, IAS 1 requires the Company to classify the entire balance of the CIC Convertible Debenture as a current liability as at March 31, 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.

#### Ovoot Tolgoi Mine Impairment Analysis

The Company determined that an indicator of impairment existed for its Ovoot Tolgoi Mine cash generating unit as at March 31, 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 and washing assumptions, operating cost and life of mine coal production assumptions as at March 31, 2018. The Company's Ovoot Tolgoi Mine cash generating unit carrying value was \$81.3 million as at March 31, 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 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 13.4% 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 March 31, 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.

## REGULATORY ISSUES AND CONTINGENCIES

### *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.

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.

Leave to appeal is expected to be decided by June 2018. If leave to appeal is granted, the appeal would likely be scheduled to be heard in early 2019. A ruling on any appeal would not be expected before September 2019.

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 March 31, 2018 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 at March 31, 2018 is 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 that its development projects may be affected, but not its 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 a protected area boundary. The overlapping area 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.

#### *Mongolian royalties*

During the year ended December 31, 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 March 31, 2018, recognition of a provision for additional Mongolian royalties is not necessary.

#### 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.

On April 26, 2018, the Board of RDCC LLC increased the toll rate from MNT 1,200 per tonne of coal to MNT 1,500, effective from June 1, 2018.

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

For the three months ended March 31, 2018, RDCC LLC recognized toll fee revenue of \$1.6 million (2017: \$1.2 million).

## OUTLOOK

With the implementation of the "One Belt, One Road" program in China, the Company is well positioned to capture the resulting business opportunities between the two countries given the potential strategic support from its largest shareholders (CIC and Cinda), which are both state-owned-enterprises in China, and its strong operational record for the past ten years in Mongolia, being one of the largest enterprises in the country.

Assuming the successful launching of the Company's processing facilities in the coming months, the Company expects to produce and sell higher volumes of higher-quality coal products to the Chinese market at improved margins. The Company will continue to strive for revenue growth by expanding its customer base further inland into China.

Looking forward, the Company remains cautiously optimistic regarding the Chinese coal market.

The Company continues to make efforts to strengthen cost management to ensure operating efficiency.

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 the potential strategic support from its largest shareholders (CIC and Cinda), which are both state-owned-enterprises in China, and its strong operational record for the past ten years in Mongolia, being one of the largest enterprises in the country.

- Strategic location &ndash; 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.
- A large resources and reserves base &ndash; As a result of work performed by Dragon Mining Consulting Limited for the Ovoot Tolgoi Deposit, the Company's aggregate coal resources include measured and indicated mineral resources of 194.6 million tonnes and inferred resources of 32.1 million tonnes while 114.1 million tonnes were declared as mineral reserves.
- Several growth options &ndash; 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 2018 and the medium term are as follows:

- Enhance product mix &ndash; The Company is committed to enhancing the product quality by completing the 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 &ndash; The Company aims to strengthen its sales and logistics capabilities to expand the customer base further inland in China.
- Optimize cost structure &ndash; 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. Meanwhile, the Company is expecting there will be a significant level of stripping work to be performed at the Sunrise pit in the upcoming 12 months to ensure a sustainable coal production over the mine life. In order to finance the stripping work, the Company will reduce the production level while utilizing the existing balance of inventory to meet the sales target.
- Progress growth options &ndash; Subject to available financial resources, the Company plans to further the development of the Soumber Deposit, while complying with all government requirements in relation to its licenses and agreements.
- Diversify the risk profile of the Company &ndash; 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.
- Operate in a socially responsible manner &ndash; 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	
March 31,	
2018	2017

Revenue	\$ 23,223	\$ 25,254
Cost of sales	(16,507 )	(23,759 )
Gross profit	6,716	1,495
Other operating expenses	(1,338 )	(3,208 )
Administration expenses	(2,377 )	(2,385 )
Evaluation and exploration expenses	(124 )	(29 )
Profit/(loss) from operations	2,877	(4,127 )
Finance costs	(6,006 )	(5,715 )
Finance income	258	4
Share of earnings of a joint venture	340	266
Loss before tax	(2,531 )	(9,572 )
Current income tax expense	(929 )	(45 )
Net loss attributable to equity holders of the Company	(3,460 )	(9,617 )
Other comprehensive income to be reclassified to profit or loss in subsequent periods		
Exchange differences on translation of foreign operation	(3,328 )	259
Net comprehensive loss attributable to equity holders of the Company	\$ (6,788 )	\$ (9,358 )
Basic and diluted loss per share	\$ (0.01 )	\$ (0.04 )

Summarized Financial Position Information  
(Expressed in thousands of USD)

	As at	
	March 31, 2018	December 31, 2017
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 11,265	\$ 6,471
Trade and other receivables	19,307	16,486
Notes receivables	11,498	12,520
Inventories	33,235	36,389
Prepaid expenses and deposits	7,430	6,286
Total current assets	82,735	78,152
<b>Non-current assets</b>		
Properties for resale	\$ 8,906	\$ 8,906
Property, plant and equipment	153,297	152,457
Investment in a joint venture	21,142	21,052
Deferred income tax assets	-	-
Total non-current assets	183,345	182,415
Total assets	\$ 266,080	\$ 260,567
<b>Equity and liabilities</b>		
<b>Current liabilities</b>		
Trade and other payables	\$ 81,239	\$ 79,219
Deferred revenue	32,769	27,644
Provision for commercial arbitration	14,108	13,884
Interest-bearing borrowings	7,107	7,352
Convertible debenture	123,047	116,374
Total current liabilities	258,270	244,473
<b>Non-current liabilities</b>		
Interest-bearing borrowings	89	341

Decommissioning liability	5,283	5,213
Total non-current liabilities	5,372	5,554
Total liabilities	263,642	250,027
Equity		
Common shares	1,098,625	1,098,623
Share option reserve	52,479	52,463
Exchange reserve	(8,065 )	(4,737 )
Accumulated deficit	(1,140,601 )	(1,135,809 )
Total equity	2,438	10,540
Total equity and liabilities	\$ 266,080	\$ 260,567
Net current liabilities	\$ (175,535 )	\$ (166,321 )
Total assets less current liabilities	\$ 7,810	\$ 16,094

## REVIEW OF INTERIM RESULTS

The condensed consolidated interim financial statements for the Company for the three months ended March 31, 2018, were reviewed by the Audit Committee of the Company.

The Company's results for the quarter ended March 31, 2018, 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](http://www.sedar.com) and the Company's website at [www.southgobi.com](http://www.southgobi.com).

## ABOUT SOUTHGOBI

SouthGobi, listed on the Toronto and Hong Kong stock exchanges, owns and operates its 258,000-tonne-per-year ship Oovot 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.

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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 press release 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 Company successfully negotiating a deferral of the November 19<sup>th</sup> Payments, the November 2017 PIK Interest and the May 2018 Payment under the June 2017 Deferral Agreement and CIC Convertible Debenture;
- the ability of the Company to successfully negotiate with First Concept regarding payment arrangements in respect of the Arbitration Award that are practical to and are in the best interest of the Company;
- the ability of the Company to successfully respond to any enforcement proceeding brought by First Concept in respect of the Arbitration Award;
- the ability of the Company to negotiate favorable repayment terms on the TRQ Reimbursable Amount (as described under section "Liquidity and Capital Management – Costs Reimbursable to Turquoise Hill");
- the results and impact of the Ontario class action (as described under section "Regulatory Issues and Contingencies – Class Action Lawsuit");
- 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 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 Logistic Park Project, 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 outlook and objectives for 2018 and beyond (as more particularly described under section "Outlook"); and
- other statements that are not historical facts.

Forward-looking information is based on certain factors and assumptions described below and elsewhere in this press release, 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; the capacity and future toll rate of the paved highway; plans for the progress of mining license application processes; mining methods; timing of the commencement of the washing facilities at Ovoot Tolgoi; the Company's anticipated business activities, planned expenditures and corporate strategies; management's business outlook, including the outlook for 2018 and beyond; currency exchange rates; operating, labour and fuel costs; the anticipated royalties payable under Mongolia's royalty regime; 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, 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, or changes to regulatory requirements (including environmental regulations) 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 customs clearance process at the Ceke border; the Company being in default under the CIC Convertible Debenture and the TRQ Loan, including the risk of CIC accelerating all amounts outstanding under the CIC Convertible Debenture and enforcing payment thereof, and the risk of Turquoise Hill demanding immediate payment of all amounts outstanding under the TRQ Loan; the risk of the Company failing to successfully negotiate a deferral of the November 19<sup>th</sup> Payments, the November 2017 PIK Interest and May 2018 Payment under the June 2017 Deferral Agreement and CIC Convertible Debenture; the possible impact of changes to the inputs to the valuation model used to value the embedded derivatives in the CIC Convertible Debenture; the risk of the

Company failing to successfully negotiate favorable repayment terms on the TRQ Reimbursable Amount (as described under section "Liquidity and Capital Management - Costs Reimbursable to Turquoise Hill"); the risk of the Company defaulting under its existing debt obligations, including the 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; the risk of the Company failing to successfully negotiate with First Concept regarding payment arrangements in respect of the Arbitration Award; risk that First Concept is successful in enforcing the Arbitration Award against SGS, through judicial measures in courts of Mongolia or in other applicable jurisdiction(s) and the ability of the Company to successfully defend itself against such enforcement proceedings; the outcome of the Class Action (as described under section "Regulatory Issues and Contingencies - Class Action Lawsuit" of this press release) and any damages payable by the Company as a result; the result of the internal investigation conducted by the Special Committee and the potential impact of the charges against Mr. Aminbuhe and the connection, if any, between those charges and the Company and his conduct as Chairman and Chief Executive Officer of the Company; the risk that the calculated sales price determined by the Company for the purposes determining of the amount of royalties payable to the Mongolian government is deemed as being "non-market" under Mongolian tax law; customer credit risk; cash flow and liquidity risks; risks relating to the development of the Ceke Logistics Park project, including the risk that its investment partner may not comply with the underlying agreements governing project development and may fail to meet its obligations to the Company or third parties; risks relating to timing of the commencement of the washing facilities at Ovoot Tolgoi, including identifying a reliable water source to permit operation of the washing facilities; 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, 2017, which is available under the Company's profile on SEDAR at [www.sedar.com](http://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 press release, 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 press release; 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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